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# Supreme Court of the United States

OCTOBER TERM, 1926.

No. 358.

ALBERT OTTINGER, as Attorney General of The State of New York,

*Appellant,*

vs.

THE BROOKLYN UNION GAS COMPANY.

## BRIEF ON BEHALF OF APPELLANT ALBERT OTTINGER AS ATTORNEY-GENERAL.

ALBERT OTTINGER,
Attorney-General of the
State of New York,
Capitol, Albany, N. Y.

JOHN HOLLEY CLARK, JR.,
Solicitor for Appellant Ottinger,
120 Broadway,
New York City.

WILLIAM HAYWARD,
JOHN HOLLEY CLARK, JR.,
CHARLES E. BUCHNER,
of Counsel.

Henricks & Layng, Inc., 76½ Pine Street, New York City

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# Supreme Court of the United States

ALBERT OTTINGER, as Attorney General of The State of New York,

*Appellant,*

vs.

THE BROOKLYN UNION GAS COMPANY.

## BRIEF ON BEHALF OF THE APPELLANT.

### Statement.

This case comes up on appeal from the decree of the District Court of Eastern District of New York, entered August 3rd, 1925, which declared unconstitutional Chapter 899 of the Laws of 1923.

This law was entitled "An Act to amend the Public Service Commission Law in relation to the charge for illuminating gas in cities containing a population of one million or more" and added to the then existing Public Service Commission Law, a new section, reading as follows:

> "67 (a) Charge for gas in cities of one million or more.
>
> "A gas corporation engaged in the business of manufacturing, furnishing or selling illuminating gas in a city containing a population of one million or more shall not charge or receive for gas furnished or sold in such city a sum per one thousand cubic feet in excess of one dollar, nor furnish in such city gas of a standard less than six hundred and fifty British thermal units per cubic foot, measured under normal conditions of temperature and at-

mospheric pressure. The Public Service Commission, notwithstanding any other provision of this chapter, shall not allow a rate or charge in the case of such cities in excess of such sum.

"SECTION 2. This act shall take effect immediately."

On June 1, 1923, appellee was charging $1.15 per thousand cubic feet for gas of a standard of 580 British thermal units. The rate was fixed by the Public Service Commission and was acquiesced in by appellee in October, 1922 (pp. 1522, 1534). On June 2, 1923, the law above set out fixed appellee's rate at $1.00 and raised the standard to 650 British thermal units. Appellee immediately obtained a preliminary injunction against both the rate and standard provisions of the statute, so that it has not operated under either. The Court below sustained all its contentions in a suit to declare the statute unconstitutional in a decree entered on August 3, 1925 (p. 225). From that decree this appeal has been taken.

The Assignments in Error are 107 in number (pp. 231-264), and all will be relied upon. Of these assignments several are of a general nature alleging error in failing to dismiss the complaint, failure to declare the statute constitutional, etc.

The appellant further assigns error to various particulars of the Master's report and the Court's opinion, which may be briefly classed under the following headings:

1. It is contended that the rate base found is excessive for the following reasons:

(a) The amount found by the Court below as "the original cost" of appellee's property is far too high (Assignments Nos. 3, 4, 5, 6, 7, 8, 9, 10, 11, 14, 15, 70, 87, pp. 232-235, 250, 257).

(b) The Court's finding of reproduction value and fair value was excessive and the latter approximated reproduction cost without deduction for depreciation (Assignments Nos. 19-26, 28, 62-64, 72, 74, 90, pp. 237-239, 249, 251, 252, 254).

(c) No deduction in valuation was made because of depreciation, deterioration, inadequacy or obsolescence, in spite of the fact that the properties of the appellee have been built out of a reserve for depreciation to the extent of about $12,000,000. This depreciation reserve was accumulated by charges to the cost of operation (Assignments Nos. 12, 13, 16, 19, 20, 21, 22, 73, 89, 94, pp. 235-238, 252, 257, 259).

(d) The allowance for working capital is grossly excessive (Assignments Nos. 24, 96, pp. 238, 261).

(e) No separate allowance should be made for "going value," in view of the history of the appellee (Assignments Nos. 27, 40, 95, pp. 239, 242, 260).

(f) The actual original cost of the properties transferred to the appellee company by the vendor companies was not more than $15,000,000 without deduction for depreciation, and the original cost of all the appellee's properties does not exceed $25,000,000 without deduction for depreciation as of December 31, 1923 (Assignment of Error No. 87, p. 256).

(g) The Court error in allowing excessive amounts for paving over mains and services and in failing to make any deduction from the item for services because of contributions by consumers to the cost of laying such services (Assignments Nos. 89, 91, pp. 257, 258).

2. The Court has found operating expenses which are excessive and unjustified, in that:

(a) The allocation of expenses between the appellee and its subsidiaries burdened the appellee with a larger measure of expense than is fair and reasonable (Assignments Nos. 30, 31, 32, 33, 34, 35, 42, 47, 48, 52, 53, 54, 97, pp. 240-248, 261).

(b) The amount allowed for unaccounted-for gas is excessive and unjustified (Assignments Nos. 41, 101, pp. 242, 262).

(c) Items for uncollectible bills are not proper charges to operating expenses (Assignment No. 44, p. 243).

(d) The measure of production costs was not taken at plants which fairly reflect a fair and average cost for manufacturing gas. Inexcusable inefficiency and old and obsolete plants and methods tended to increase operating costs above a fair and reasonable figure (Assignments Nos. 36, 45, 50, 57, 58, 98, 103, 104, 105, pp. 241, 243, 245, 247, 261, 263).

(e) The costs of distribution and transmission as found were excessive, and the costs of distributing repairs and transmission repairs were excessive (Assignments Nos. 46-49, 51, 57, 58, 71, 100, 103, 105, pp. 244, 246, 247, 251, 262, 263).

(f) If properly judged the actual cost of making and distributing gas in 1924 would not have exceeded 78.83 cents per M sold and net profits available for a return on investment would be 21.17 cents per M. On the basis of sales for 1923 this would amount to $3,239,089, which is a 6% return on $53,984,816 (Assignment No. 103, p. 262).

(3) The Court should not have held that the statute would be unconstitutional if the appellee did not receive an 8% return (Assignments Nos. 66, 106, pp. 249, 263).

(4) The Court should not have held the statute unconstitutional until after the appellee experimented with the rate fixed (Assignments Nos. 69, 86, pp. 250, 256).

(5) The Court should have found constitutional both the rate and standard provisions of the statute. The statute should have been construed as severable, however, and each provision of the statute should have been judged separately. If the standard provision was found unconstitutional in and of itself, the rate provision should have been upheld, and *vice versa* (Assignments Nos. 37-39, 74, 79, 80, 81, 82, 83, 84, 107, pp. 241-242, 252-255, 264).

All of these contentions were vigorously presented to the Special Master and the Court, who heard them with conscientious fairness but not, it is submitted with deference, in the attitude required in a case of this kind, to wit, of seeking every way in which the mandate of the legislature might be sustained, of insisting upon the fullest proof by appellee of all its contentions, and of resolving all doubts in favor of the statute.

Both the Master and the Court, in effect, put the burden on the appellant's and resolved almost all real doubts in favor of the appellee, as we shall attempt to show in a detailed discussion of the various issues in this brief.

## History of Company and Its Rate Litigations.

The Brooklyn Union Gas Company came into existence in November, 1895. As the Consolidated

Gas Company was brought into being to monopolize the gas business in New York so the appellee came into being in order to obtain a monopoly of the very profitable gas business in Brooklyn. The then existing companies, seven in number, had been founded at various dates from 1825 to 1879. Their business had been enormously profitable. All had paid large dividends, one of them, the Brooklyn Gas Light Company having paid 100% in one year and having averaged over 14% for forty-six years (Defts. Ex. 180, p. 2200). These enormous profits tempted competition, of course, but in spite of rate wars, dividends were maintained in that day of no public regulation. If the competition could be eliminated the resulting monopoly profits would justify large security issues and the usual handsome fees for the promoters. The rate then charged by the various competing companies was 90 cents per thousand cubic feet (Rec., p. 317). Their books purported to show a capital investment of $16,500,000 (Ex. 297, p. 2066, and finding 27, p. 96). This was undoubtedly far higher than the actual investment. These profitable but competing companies apparently had an eye simply for dividends and book surpluses, for in all their long history extending over seventy years hardly one cent's worth of property was ever apparently withdrawn from service. Capital account was charged when additions were made but was never credited when property was discarded (p. 942). However, profits were great in those days of no regulation and the securities of these companies, of a par value of $13,875,000 had a market value of $20,000,000 (Finding 29, p. 96). The enterprising gentlemen who decided to amalgamate these competing companies and capitalize the monopoly profits apparently first decided that the gas rate could be increased from 90 cents to $1.25 per thousand, an in-

crease of 40% (Rec., p. 317). The additional 35 cents per thousand in net profit would of course justify a large increase in capitalization. Accordingly, the $16,500,000 appearing as fixed capital on the old books was written up over night to $28,000,000 on the new books of the vendee company, the appellee herein (Ex. 297, Rec., p. 2066).

The new company, the present Brooklyn Union Gas Company, started business in November, 1895, with the same plants as the old but with almost double the securities outstanding. In spite of the inflation, however, the business was enormously profitable, so much so that the rate had gradually to be decreased until in 1905 it stood at $1.00 a thousand. In this year the Stevens Investigating Committee with Charles E. Hughes as its counsel, came down to New York and held hearings. Various officials of the different gas companies were put on the stand and it was revealed among other things that in New York the Consolidated Gas Company and in Brooklyn the appellee company were making enormous profits at the $1.00 rate and they had both liberally watered their securities on obtaining their respective monopolies. Mr. Staniford, still a faithful employee of the appellee, testified with certainty and assurance as to the writing up of the capital accounts of appellee $12,000,000 to represent "good will," "franchises" and other euphonious names for water (Rec., p. 797).

As a result of these disclosures the rate of 80 cents per thousand was fixed by the legislature in 1906. The Consolidated company obtained a preliminary injunction restraining the operation of this law. So great were the profits of both companies even at 80 cents per thousand that it was necessary to claim that the deterioration of the property, particularly of the mains from electrolysis, was and would be so great that 10 cents per

thousand must needs be set aside to take care of this depreciation and guard against extraordinary casualties (Finding 63, p. 109). The Supreme Court was not impressed by this claim and upheld the statute.

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The 10 cents or a lesser amount per thousand continued to be set aside, however, until 1915 and out of it a fund was created and increased to $10,000,000 (Finding 67, p. 111).

With the increased prices during the war the 10 cent reserve had gradually to be given up and finally in 1919 suit was brought to have the 1906 statute declared unconstitutional. In this suit the District Court found that the fair value of appellee's property was $27,916,448 and the cost of making gas and distributing gas to be 78.53 cents per thousand. Brooklyn Union v. Nixon, 2 Fed., 2nd, 118. The suit was tried in 1920 when as is well remembered prices were at their post war peaks. Even then, however, the company with a $1.00 rate would have had a return of over 13 per cent. on the value of its property, as found by the Court.

The statute was declared unconstitutional and as a result the appellee was enabled to charge, for a time, what it pleased. In 1921 it had a rate for some time of $1.50 per thousand which it later voluntarily reduced to $1.25 per thousand.

In 1922 prices were going down rapidly and an additional rate cut was apparently necessary. Negotiations were accordingly undertaken with the Public Service Commission with the result that orders were made and accepted fixing the rate of $1.15 per thousand and fixing the standard of gas at 537 British thermal units.

The reduction was not substantial as the gas prescribed cost 5 cents less to make than the 22 candle power gas. The reductions from $1.25 to $1.15 was therefore a real reduction of only 5 cents per thousand. The new rate, in spite of many polite expressions in the letters which passed between the company and the Public Service Commission, has been eminently satisfactory to the company and has been continued without demur for four years first under the order and later under the temporary and final injunctions in this case.

In June, 1923, the legislature passed the statute here complained of fixing the rate of $1.00 per thousand and in a later clause, the standard at 650 British thermal units. The company—probably in fear of public clamor—had not by this time depreciated its gas to the low standard allowed by the Public Service Commission, but was furnishing a gas which tested at the works about 590 to 600 British thermal units per cubic foot. This gas it has continued to furnish and it is on making such gas that the actual operating expenses are based. The difference in cost between manufacturing such gas and 537 British thermal unit gas and between the gas actually made and 650 British thermal unit gas is conceded to be from 2 to 3 cents per thousand respectively more or less.

The real question then is whether the cut in rates of 15 cents for the same gas, 17 cents for 650 British thermal units gas or 13 cents for 537 British thermal units gas is sufficient to make the rate confiscatory. This of course depends first on what is the fair value of its property for the purposes of this case and second on what it actually cost and will cost appellee to make gas.

## The Plaintiff Company and its Present Operations.

Before entering on a discussion of the legal questions involved it will be well to indicate briefly the physical and financial characteristics of appellee company and its properties.

Plaintiff on June 1, 1923, furnished gas through 465,909 meters on 147,687 service pipes attached to 1,018 miles of main (Finding 47, p. 106). During the year 1923 the company sold to its own consumers 15,300,373.5 M cubic feet of gas (Finding 177, p. 145).

Plaintiff owns all the securities of and manufactures all the gas sold by its subsidiary companies the Newtown Gas Light Co., in the Second Ward of Queens, The Flatbush Gas Co., in Flatbush and three companies which divide the Fourtn Ward of Queens. These companies are the Jamaica Gas Light Co., The Richmond Hill & Queens Gas Light Co., and The Woodhaven Gas Light Co. (Finding 118, p. 124).

The territory served by these subsidiary companies is rapidly building up and the demand for gas rapidly increasing. The companies make no gas whatever, have no independent officers or real existence. They are in fact merely part of the distributing system of the appellee company, and render it easy for that company by performing services for its subsidiaries not properly charged against them, to inflate its own operating expenses. We shall show how consistently this has been done.

These companies in 1923 sold 4,420,067.1 M cubic feet of gas or about 25% of the sales of plaintiff (p. 1952, fol. 2869). All of this gas, together with that sold by appellee to its own consumers was manufactured at five substantial plants with an average daily capacity of over 20,000,000 cubic feet per day each and at one inefficient little plant, the Equity

Works, with no modern appliances and a daily capacity of only 2,500,000 cubic feet per day (Finding 45, p. 104).

The gas manufactured was all so-called water gas. Such gas is made by gasifying steam by passing it through a very hot fire. The resulting gas is a blue gas with no lighting power. Gas oil is then sprayed in and mixed with this blue gas resulting in the addition of both heating and lighting value. Appellee's engineer testified that 3 gallons of gas oil per M would produce gas of 16.5—18.5 candle power and containing 540 British thermal units per foot. The use of 4 gallons per M would give a gas of 22 to 25 candle power and containing 625 British Thermal Units per foot (p. 397).

## Comparison of Rates.

The appellee company was free to fix its own rates without regulation from May 14, 1921 to Oct. 1, 1922. On May 14, 1921, it fixed a rate of $1.50 per M until August 1, 1921, and then reduced its rate to $1.25 per M, where it remained until Oct. 1, 1922, when under pursuance of an order of the Public Service Commission, in which the company acquiesced, the rate was reduced to $1.15 per M, where it still remains.

The Brooklyn Union Gas Company is second only to its sister company, the Consolidated Gas Company, in possessing the most favorable and fertile gas territory in the world. Its density of consumption is far greater than in any other city of the United States. Its territory is so congested that it should distribute gas more cheaply than is done in any other city of the United States, with the exception of the Borough of Manhattan, where the Consolidated Gas Company operates.

It is interesting, therefore, to note that despite its advantageous position, the appellee company

has been and is receiving rates in excess of those charged in cities where the cost of production and distribution would naturally be higher. In the city of Chicago, the Peoples Gas Light Company in 1914 was charging 80 cents per M cubic feet, gross. Today this Chicago company is content with a rate of 95 cents per M as against the $1.15 per M rate which the Brooklyn Union Gas Company is now receiving. That the Chicago situation is not abnormal is revealed by considering the rates in many less favorably situated cities. A summary of the rates in several other cities, with the consumption per M of main, in the years 1914-1923, is shown in Brown's Directory of Gas Companies, as follows:

| City | Rate in 1914 | Rate in 1923 | Increase Amt. | Increase % | Sales per Mile of Main 1914 | Sales per Mile of Main 1923 |
|---|---|---|---|---|---|---|
| New York (Bklyn. Union Gas Co.) | $ .80 | $1.15 | .35 | 44 | 11,700 | 14,581 |
| Chicago | .80 | (2) .95 | .15 | 19 | ——— | 9,161 |
| Philadelphia | 1.00 | 1.00 | — | — | 6,410 | 10,729 |
| Washington | .85 | 1.00 | .15 | 18 | 5,125 | 8,692 |
| Denver | .80 | .95 | .15 | 19 | 3,381 | 5,665 |
| Rochester | .95 | (1) 1.00 | .05 | 5 | 4,276 | 7,436 |
| St. Louis | .80 | (1) 1.00 | .20 | 25 | 5,306 | 6,774 |

(1) Minimum charge 50c.
(2) Plus minimum charge.

This table shows a situation that at least should arrest the attention of this court. While smaller and less favored companies have been content with increases since 1914 that do not rise above 25% and in some cases are substantially less, the Court in this case has declared that a 25% increase to the appellee company is confiscatory and, under injunction, has permitted this company an increase that amounts to about 44% over and above the rate charged in 1914. And the increased price is for inferior gas.

## POINT I.

**The proper rate base for plaintiff company in a confiscatory case of this kind or the fair value of its property, used and useful in its gas business and upon which it is entitled to a return does not exceed the sum of $35,000,000.**

The Master has found a rate base for the appellee company of $55,000,000 as of June 1, 1923, and $58,000,000 as of December 31, 1923 (Finding 109, p. 118, Opinion, p. 68). He arrived at these figures generally as follows: First, he found what he styles original cost at $39,000,000, a book value at $46,000,000 and a reproduction cost at $57,800,000 and arrived at the conclusion that the "fair value" of the properties of the plaintiff company may be placed at $50,000,000 "for the purposes of this action." To this fair value figure he adds $5,000,000 for working capital and about $3,000,000 for additions to capital between June 1, 1923 and December 31, 1923, thus arriving at his rate base of $58,000,000 (pp. 67, 68). The Court made substantially the same findings (p. 216). The appellant contends that the original cost as estimated by the Master is not the original cost of the properties of the appellee company. He contends further that the book value is far less than $46,000,000 and that the reproduction cost, as found in the amount of $57,800,000 in exorbitantly excessive. He further contends that in arriving at fair value under all the circumstances in the instant case, the Master placed entirely too great a reliance upon reproduction value new (*without any deduction for depreciation*) and did not give due credit and allowance for the other elements which the Supreme Court of the United States has declared should be considered in arriving at an estimate of fair value in rate cases.

Before going into our argument upon the figures that the Master should have found we will set out as shortly as possible some of the leading decisions in the Supreme Court of the United States, upon the question of arriving at a fair value of a public utility company's property.

The leading case of Smyth v. Ames, 169 U. S., 466, sets forth the relevant elements which should be taken into consideration in determining fair value. In that case the Court at page 546 said:

> "* * * And in order to ascertain that value (fair value) the original cost of construction, the amount expended in permanent improvements, and amount and market value of its bonds and stocks, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by the statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case."

In the Minnesota rate cases, 230 U. S., 352, Mr. Justice Hughes, speaking for the Supreme Court said:

> "The ascertainment of that value (fair value) is not controlled by artificial rules. It is not a matter of formulas, *but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts.*" (Italics ours.)

Without quoting from the authorities at any further length, it is generally conceded that "fair value" is to be found by a Court or a Commission, by the exercise of sound judgment based upon a consideration of many elements of value and a fair

consideration of the relevant facts. The perplexing question is the proper weight to be given to the various elements in reaching a determination of fair value.

In the State of New York the State Legislature has indicated that a predominant element in the fixing of a rate base shall be the bona fide investment of the company or the "capital actually expended." In the case of the Kings County Lighting Co. v. Lewis, 180 New York Supplement, 570, the Court points out that the amendment of 1910 of the Public Service Commission Law, conferred the power upon the Commission to fix maximum rates, having due regard among other things to a reasonable average return upon *"capital actually expended."*

The trend of decisions indicated by recent cases in the Supreme Court of the United States and by Public Service Commissions throughout the country seem to indicate that "prudent investment" is at least a surer basis for fixing the fair value than the opinion evidence of reproduction cost.

In one of the recent cases in the Supreme Court of the United States, *Georgia Railway & Power Co.*, 262 U. S., 625, the value of the property fixed by the Commission and the lower court approximated investment value and was only about 50 per cent. of reproduction value new. The Supreme Court held this to be a fair valuation, saying (pp. 629, 630):

> "The case is unlike the *Missouri ex rel. Southwestern Bell Telephone Co.* v. *Public Service Commission, ante,* 276. Here the Commission gave careful consideration to the cost of reproduction; but it refused to adopt reproduction cost as the measure of value. * * *"
>
> "That part of the rule which declares the

utility entitled to the benefit of increases in the value of property was specifically applied in the allowance of $125,000 by the Commission to represent the appreciation in the value of the land owned."

"The lower Court recognized that it must exercise an independent judgment in passing upon the evidence; and it gave careful consideration to replacement cost. But it likewise held that there was no rule which required that in valuing the physical property there must be 'slavish adherence to the cost of reproduction, less depreciation.' It discussed the fact that since 1914 large sums had been expended annually on the plant; that part of this additional construction had been done at prices higher than those which prevailed at the time of the rate hearing; and it concluded that 'averaging results, and remembering that values are * * * matters of opinion,' * * * no constitutional wrong clearly appears.

"The refusal of the Commission and of the lower Court to hold that, for rate-making purposes, the physical properties of a utility must be valued at the replacement cost less depreciation was clearly correct."

It is clear both from this case and from Smyth v. Ames (supra), that the first element for consideration is "original cost of construction."

**The real book cost of the plaintiff's physical properties does not exceed the sum of $29,000,000, and the "original cost of construction" of the properties is considerably less than this figure.**

The Master has found that the original cost of the plaintiff company has not been established, but he has estimated the same as "closely approximat-

ing $39,000,000" and he has found the book value to be about $46,000,000 (Master's Opinion, pp. 44-48).

A concise statement of the history of the company becomes necessary in order to understand the true merits of the questions here involved.

The Brooklyn Union Gas Company was incorporated in September, 1895, and in November, 1895, it acquired by purchase all of the properties and franchises of the seven independent gas companies that were then operating in the City of Brooklyn (Findings 2 and 3, p. 88).

The purchase price to the vendor companies was $15,000,000, paid in stock of the vendee company, par value, and $10,600,000 of the vendee company's first mortgage 5% bonds, and an additional $3,900,000 of such bonds which were reserved for the retirement of bonds of equal par value of the vendor companies (Finding 35, p. 100). The purchase price was, therefore, approximately $29,500,000 paid in the securities of the vendee company (Master's Opinion, p. 44).

In an effort to arrive at the original cost of the properties of the vendor companies it becomes important to inquire into the respective dates of their incorporation, and the various dates on which construction of their plants was commenced. The following table shows these elements:

| Name of Predecessor Company | Date of Incorporation | Date of Commencement of Construction (Miller pp. 1137, 1138) |
|---|---|---|
| Brooklyn Gas Light Company | April 18, 1825 (Chap. 204, Laws of 1825) | 1849 |
| Williamsburg Gas Light Company | July 5, 1850 | 1850 |
| Peoples Gas Light Company | Nov. 17, 1864 (Amended certificate filed Feb. 25, 1871.) | 1869 |

| | | |
|---|---|---|
| Nassau Gas Light Company | July 3, 1869 | 1870 |
| Metropolitan Gas Light Company | Feb. 20, 1871 (Amended certificate filed Feb. 25, 1871.) | 1871 |
| Fulton Municipal Gas Company | March 5, 1879 | 1879 |
| Citizens Gas Company (Formed from consolidation of Citizens Gas Light Company and Union Gas Light Company) | April 1, 1892 | |

These vendor companies had enjoyed a long period of prosperity. The Brooklyn Gas Light Company paid an average yearly dividend over a period of 46 years of over 14%; the Williamsburg Gas Light Company over a period of 36 years, 9%; the Fulton Municipal Gas Company for a period of over 12 years, from 1883 to 1895, 9½%; the Metropolitan Gas Light Company for over a period of 22 years, 6%; the Peoples Gas Light Company for over a period of 15 years, 5.9%, and the Nassau Gas Light Company for over a period of 21 years, 6% (Defts. Ex. 180, p. 2200).

Shortly before the purchase of these companies by the plaintiff, the vendor companies were charging 90 cents per M cubic feet for gas. This rate was raised to $1.25 and continued in effect by the plaintiff company until 1901 (pp. 316, 317).

The plaintiff introduced Exhibit marked "297" (p. 2066) though the company's witness, Mr. Mount, from which it appears that the vendor companies on November 4, 1895, the day that the sale was consummated by the plaintiff company, record final journal entries of their capital accounts in the total amount of $16,524,095.35. The opening journal entries, however, of the plaintiff company, as of the same date, were in the amount of $28,799,731.92, or an increase of $12,275,636.57 for the identical

properties. The Master has so found (Finding 27, p. 96, Opinion, p. 44).

Mr. Staniford, vice-president of the Brooklyn Union Gas Company, testified before the Stevens Committee in 1905 that this difference, $12,275,636.57, between the closing entries on the vendor's books and the opening entries on the vendee's books resulted from an addition of $4,000,000 or $5,000,000 to the book value of street mains for rights in the streets; about $5,000,000 added for good will; and $3,050,000 added for rights of the vendor companies to make and sell gas. His testimony upon these matters was clear and beyond any question of doubt.

On cross examination in this case he was asked the following questions in regard to his testimony in 1905 and confirmed it by the following answers:

> "Q. Were you asked this question, Mr. Staniford, by Mr. Hughes.
>
> "Q. 'What was represented by the items 'Franchises and Rights'? I find in the case of the Brooklyn Union Gas Light Company, $3,050,000 were you asked that question?"
>
> "A. I think I was.
>
> "Q. And did you make this answer: 'And you will find, Mr. Hughes, if you take the aggregate of those amounts and add it to that account for each company, you will find the aggregate to be $3,000,000, did you make that answer?
>
> "A. I think my answer was $3,050,000."
>
> * * * * * * *
>
> "And then he asked you this question—
>
> 'Q. Do you remember what you added for that right (the right to have mains in the streets) of the Brooklyn Union Gas Light Co.?

'A. I do not.

'Q. Well, approximately?

'A. Not taking each company, I don't.

'Q. Do you know the amount added for them altogether?

'A. I think between $4,000,000 and $5,000,000.

'Q. That was added to the Street Mains Account?

'A. Yes, sir.

'Q. That is distinct from these items that I find under the head of Franchise and Rights?

'A. Absolutely.'

"You recollect that?

"A. I think that is correct, I think that is what I said."

* * * * * * *

"Q. Mr. Hughes asked you these questions, did he not, Mr. Staniford:

'Q. Are you able to tell me today how much was added to plant account at the time of your organization from the book value of the plant as it stood on the books of the constituent companies, taking them in the aggregate?

'A. No, I am not.

'Q. Can you approximate it?

'A. I stated yesterday that I thought the good will in that item would approximate in the neighborhood of $5,000,000; I think that was my testimony yesterday.'

* * * * * * *

'Q. So that that $5,000,000, added to the plant account and the $4,000,000 added to the street mains account and then the item of $3,050,000 for franchises which were put upon your books at the time of the organization of your company.

'A. Yes, sir.

'Q. Which do not appear in the books of the constituent companies or the books from which your properties were derived?

'A. Yes, sir.

'Q. A total of about $12,000,000?

'A. Approximately.'

"Q. Is that correct?

"A. That is as near correct as I can remember it" (pp. 794-797).

This was Staniford's testimony before a Legislative Committee under examination by Mr. Hughes in 1905, ten years after the consolidation of the independent companies that make up the Brooklyn Union Co. He was an officer of the company and there is no reason so far as the Attorney-General conceives for doubting either the truth or accuracy of his statements. Nothing that the appellee can now advance upon this score, either the dexterous arguments of counsel or the opinion evidence of paid experts can refute with any degree of success the sworn testimony of this officer in 1905.

Yet what was the course of plaintiff and of the Master and Court below in regard to this very pertinent testimony? The appellee took the astonishing position that Staniford, its old and trusted employeee had testified to matters he knew nothing about before the Committee in 1905. When Staniford was first called to the stand a tremendous battle was put up by appellee's counsel to prevent his being cross examined about them (pp. 288-303). The effort was successful for the time.

But afterwards this damaging testimony had to go in. To it the only answer ever made by appellee's counsel is in effect that Mr. Staniford is a simple soul, that he was taken away from the protecting influence of Mr. Dykman by Mr. Hughes

and swore to a great many things that he knew nothing about. Since then he has reformed and when called in this case with Dykman's eye upon him, told the truth which was that he knew nothing of the $12,000,000 of water in 1905.

The Master, strangely, seems to have subscribed to this bizarre theory. He does not mention Staniford's testimony at all, though plainly if he were really seeking original cost he would have seized on it as the most important bit of evidence in the case.

The Court in its opinion (pp. 208, 209) disposed of this matter as follows:

> "Defendants contend that in attempting to arrive at cost or book value, there should be deducted from $28,799,731.92, the valuation at which the purchased properties were originally entered on the books of the plaintiff, the sum of $10,475,636.57 in addition to the sum of $3,050,000, the valuation of franchises and rights, which the Master has already deducted, which would leave $15,095.35, the sum which defendants contend should be taken as showing cost or book value at that time.
>
> "To support this, defendants point to the testimony of a Vice-President of the plaintiff before a legislative committee in 1905, when in substance he said, in reply to questions about the difference between the closing entries in the books of the vendor companies and the opening entries in plaintiff's books, that $3,050,000 represented franchises and rights, $4,000,000 was added to the Street Main Account, and $5,000,000 was added to the Plant Account for the right to do business, a total of about $12,000,000.
>
> "This does not, however, seem to me to be conclusive, because the witness in his testi-

mony before the committee was evidently in error when he said that $5,000,000 was added to the Plant Account, as the evidence shows that the closing entry on the books of the vendor corporations was Plant & Patents $9,731,384.83, and the plaintiff's opening entry was $10,687,853.31 a difference of less than a million, instead of five.

"Furthermore, substantially all of the items seem to have been written up, and while there is a large increase in the valuation of street mains, there is also an increase of approximately $2,700,000 in the value of land.

"The transaction between the plaintiff and the vendor companies was not a consolidation nor a merger, but a simple purchase preceded by negotiations, and I see no reason to believe that the plaintiff paid to the vendor companies more than it considered a fair price for their assets."

The Court does not accurately state appellant's contention which was not that the amount of the write up of $12,275,000 plus $3,050,000 included in the new books for franchises be deducted but that the $12,000,000 plus $1,250,000 included in the old books be deducted. The purpose of the Court and the object of the Court's inquiry should have been to determine as nearly as possible "original cost of construction." This purpose is not served by any attempt to justify a sales price, so-called, as "fair." In view of the enormous profits of the vendor companies no doubt the price was "fair." It was not, however, original cost of construction. To find that it is necessary to exclude this $12,000,000.

This would seem to follow inevitably from the conclusions of the Court below excluding the

$3,050,000 for franchises. Mr. Staniford's testimony was that "good will" was added in the sum of $5,000,000, and that about $5,000,000 was added for the "right to have mains in the streets."

It is exceedingly difficult to distinguish between "franchises and rights" on the one hand and "good will" and the "right to have mains in the streets" on the other. Yet the Court below has excluded $3,050,000 for franchises and has included the other two items.

Nor does the fact that the $5,000,000 does not appear in the particular "Plant" account mentioned seem to settle the matter. $5,000,000 for "good will" certainly appears as an inflation to the various accounts including "plant, real estate, services, etc." The fact that stood out in Staniford's recollection and the fact exactly borne out by the tables is that $12,000,000 was added for intangibles of which $4,000,000 or $5,000,000 was for "good will," $4,000,000 or $5,000,000 for "right to have mains in streets" and the balance for "franchises and rights." The comparative figures bear this out exactly.

These figures are as follows (see Deft.'s Ex. 297, p. 2066).

| Accounts | Complainant's Opening Balances | Vendors' Ledger Balances | Write-Up |
|---|---|---|---|
| Real Estate | $ 5,349,400.00 | $ 2,619,226.48 | $ 2,730,173.52 |
| Plant & Patents | 10,687,853.81 | 9,731,384.83 | 956,468.98 |
| Street Mains | 7,556,165.98 | 2,216,501.94 | 5,549,664.04 |
| Meters | 1,020,919.88 | 1,014,077.85 | 6,842.03 |
| Services | 934,298.00 | 164,475.65 | 769,822.35 |
| Meter cocks & connections | 163,012.50 | 19,791.90 | 143,220.60 |
| Office furniture & fixtures | 24,500.00 | 6,851.70 | 17,648.30 |
| Horses, wagons & harness | 13,581.75 | 1,785.00 | 11,796.75 |
| Franchises and rights | 3,050,000.00 | 1,250,000.00 | 1,800,000.00 |
| Depreciation | | (Credit) 500,000.00 | 500,000.00 |
| | $28,799,731.92 | $16,524,095.35 | $12,275,636.57 |

In the absence of clear and convincing evidence that the books of the vendor companies were incorrect the figure shown therein should have been accepted by the Master. There is a strong presumption that these books were correctly kept and certainly the entries made therein may be used as an admission against interest and are clearly competent evidence, unless specifically refuted, that the amounts therein shown were the value of the company's properties on the dates of entry.

17 *Cyc., page* 395, *upon the question of book entries as admissions against owner of books says:*

> "A statement contained in a book entry may, like verbal or other written admissions, be competent evidence against the party by whom or under whose direction the entries were made."

The character or form of the book is immaterial. Where the book contains entries against interest, the party to whom the book belongs will not be heard to object to either the entries, the form of the book, or the manner in which the entries were kept. *Loewenthal* v. *McCormick*, 101 Ill., 143; *Barry* v. *Foyles*, 1 Pet. (U. S.), 311.

In the case of *Dewey* v. *Hotchkiss*, 30 N. Y., 407, it was held that where the adverse party calls for and introduces a book in evidence, all entries touching the subject are thus made evidence, the self-serving as well as the self-disserving entries.

In the case of *McCay* v. *Lamar*, 12 Fed., 367, entries in the books of a decedent of property owned by a party unknown are satisfactory proof of ownership in the party.

In the case of *Missouri Railway Co.*, Elliott, 102 Fed., 96, it was held that a schedule of the Railroad Company showing wages paid to its train-

men is competent evidence against the company to establish the wages earned by employees in its service.

The case of *Dolittle* v. *Stone*, 136 N. Y., 613, was an action for accounting. It held that in an action against an administrator for an accounting as to funds in the hands of his intestate belonging to the plaintiff, a book of accounts kept by the intestate in regard to said funds was competent evidence as against the estate.

In the case of *Saugerties Bank* v. *Mack*, 54 N. Y., Supp., page 360, the Appellate Division of the First Department, New York, held that in an action to set aside a transfer from a son to his mother, books of account kept by the son showihg that certain loans had been repaid were admissable, both against the son and the mother. Similar New York cases holding that book entries may be used as admissions against interest are *Goetting* v. *Weber*, 75 N. Y. Supp., 890; *Kilpatrick* v. *Goldsmith*, 80 N. Y. Supp., 835; *Card* v. *Card*, 39 N. Y., 317; *Gray* v. *White*, 59 N. Y., 236; *Simmons* v. *Haven*, 101 N. Y., 427.

These rules are pertinent here as the plaintiff was really only a continuation of the vendor companies and has for thirty years used its original entries which are based on the final balances in the vendor books as the foundation stone in its entire bookkeeping structure. The statement of the Court below that this was not a merger but a "simple purchase preceded by negotiations" does not give an accurate view of the situation. While in terms it was a sale, in fact the Brooklyn Union Gas Company was formed only two months before the so-called "purchase," had no real substance before the "purchase" and in reality grew out of the "purchase." In fact it was a merger though nominated a sale.

An examination of the books of the vendor companies discloses the fact that it was not the practice to credit capital accounts for withdrawals, so that these vendor companies, some 50 years old, at the time of the consolidation, carried in their capital accounts all additions to their property with few if any credits for withdrawals (as an instance see Saffer, p. 1332). It is needless to argue, therefore, that these capital accounts were far in excess of the original cost of properties in actual use in 1895. The only offsetting fact is that some of the companies to disguise profits had charged construction to operations to a certain extent. To how great an extent does not definitely appear but there is no question that it did not offset the failure to credit capital with withdrawals.

It is fair to assume, therefore, that the original cost is far less than the figure we indicate as correct for book value. As additional proof of this many of the accounts show that the total sums carried were much larger than original cost could under any circumstances possibly have been. The Meter Account is a fair example of this. The Meter Account was opened on the books of the vendee company, in the sum of $1,020,919.88 and stood on the vendors' books at approximately this amount. Mr. Payne, auditor of the company, presented a statement showing the number of meters taken over from the vendor companies as 113,067 (p. 946). He further testified that the amount of money in the opening account represented the cost of the meters taken over from the vendor companies (p. 2066). It would appear therefore, from these figures, that the cost of the meters taken over by the vendee company averaged $9.03 each per meter (Master's Finding No. 51, p. 108). Mr. Payne was unable to state the various sizes of the meters taken over but the defendants showed that in the years 1895 and 1896, according to the actual purchases

made by the company, the cost of three-light meters was from $4.30 to $4.80 per meter (Master's Finding No. 53, p. 108), and the cost of five-light meters $5.09 to $6.08 per meter (Master's Finding No. 56, p. 108). It appears also from the books of the company that three-light meters were withdrawn at the cost of $4.16 to $4.72 per meter (Master's Finding No. 55, p. 108); that five-light meters were withdrawn at prices ranging from $5.09 to $6.08 per meter (Master's Finding No. 56), p. 108); ten-light meters were withdrawn at $6.51; twenty-light meters at $9.26; and thirty-light meters at $14.01 (p. 1011). At the present time when the consumption of gas per meter is greater than it was in 1895, the majority of meters in this district are five-light meters. In 1895 the three-light meters were in use to a far greater extent than today. In fact undoubtedly the majority in use at that time were three-light meters. The number of large size meters, larger than five-light, is inconsequential, even today, so that the average price would be affected very little by the small number of large size meters in use at that time. Basing the cost of meters, therefore, on the five-light size, the opening figures in the vendee's books should have been $687,447, instead of $1,020,919.88. On this item alone, there is an inflation of about 50%. The vendor companies carried the account meters at approximately $1,000,000. It must be apparent, therefore, that the vendor companies carried their meters at a figure at least 50% over their cost new without any deduction for depreciation. If this were so in the case of meters it was probably so in the case of mains, services, fixtures, plants and all other items set forth in the various accounts. If the ratio of inflation in meter account were carried into the other accounts it would indicate an actual original cost of not more than $11,000,000 of the properties

of the vendor companies. This estimate of original cost is confirmed by the actual capitalization of the vendor companies. The capital stock of the vendor companies in 1895 totaled $9,970,000 par value and their outstanding bonds amounted to $3,900,000 par value. In other words, the outstanding securities of the vendor companies did not exceed $14,000,000 par value (Master's Report, p. 46). This, at least, in conjunction with our estimate of original cost is some indication of what the properties actually cost the vendor companies. It certainly is a more persuasive and logical estimate than the concededly inflated figure used by the Master and by the Court below.

There can be no doubt that in ascertaining the book cost of the plaintiff's property we should begin with the closing entries in the vendor's books $16,254,000 and not as the Master did, start with a figure inflated by over $12,000,000 for intangibles. There should be added $20,399,402.01, the aggregate net additions to capital subsequent to November 4, 1895, as shown by the books (p. 47). To this should be added the amount paid by the plaintiff to acquire the Equity gas works, $568,066.00 (p. 47), making a total of $36,241,563.36. From this should be deducted, as the Master finds on page 47 of his opinion, $4,000,000, representing the withdrawals from capital between November 4, 1895, and December 31, 1908, fixed by the stipulation of the attorneys for the respective parties, as well as 10% of the remainder as used by the subsidiaries. The balance is approximately $29,000,000. This should have been the finding for book cost of the tangible property, and original cost undoubtedly is many millions of dollars less than this figure.

And an additional indication of inflations we point out that the rate of $.90 per M of the vendor companies was immediately increased to

$1.25 per M by the newly formed Brooklyn Union Co. an increase of about 40%. The additional $12,000,000 in capitalization was in effect a capitalization of increased future earnings under a monopoly system of supplying gas as opposed to the former competitive system which had reduced the rate to $.90 per M.

Another supporting indication of original inflation in the vendor companies' books is found in the stipulation above mentioned. The books of plaintiff company, kept by the same men who had kept the vendor books failed to show any retirements in plant account for many years (p. 1007). When this was brought out on cross examination plaintiff's counsel sensed the danger to his books as accurate records. He frankly admitted that they had been improperly kept and offered to stipulate that $4,000,000 worth of property which had been withdrawn had never been credited to capital account saying:

> "I think I can prepare a statement upon that subject which will embrace all that Mr. Cummings can possibly prove" (pp. 947,948).

Such a stipulation was made and that appellee was willing to do so indicates the extent to which the books over valued rather than under valued the property (p. 1009).

Original cost of construction and book value are elements pointed out in the case of Smyth v. Ames, to be considered in determining the fair value of the property of a utility company for rate making purposes.

**The outstanding securities of the plaintiff company indicate a capitalization of not over $33,500,000.**

The Master found that outstanding securities represent a capitalization of $46,500,000 and have a market value of $48,750,000 (Master's Opinion, p. 48). In his findings (No. 38, p. 101) he sets forth the capitalization of the plaintiff on June 1, 1923, as follows:

| | | |
|---|---|---|
| "Capital stock (authorized $30,000,000) issued | | $18,000,000 |
| The Brooklyn Union Gas Co. 5% 1st Consolidated Mortgage Bonds, due 1945 | $14,736,000 | |
| The Citizens Gas Light Co. 5% Consolidated Mortgage Bonds, due 1940 | 264,000 | |
| The Brooklyn Union Gas Co. First Lien and Refunding Mortgage 6% Gold Bonds, due 1947 | 6,000,000 | |
| The Brooklyn Union Gas Co. 7% Convertible Debentures, due 1929 | 2,000,000 | |
| The Brooklyn Union Gas Co. 7% Convertible Debentures, due 1932 | 5,579,000 | $28,579,000 |
| | | $46,579,000" |

The Master did not take into account that the Brooklyn Union Gas Company owns and controls five subsidiary companies—the Flatbush Gas Company, the Newtown Gas Company, the Richmond Hill & Queens County Gas Light Company, the Jamaica Gas Light Company, and the Woodhaven Gas Light Company. The securities set forth in the above table represent the capitalization, not only of the plaintiff company, but of all of its subsidiaries. In order to arrive at what would be a fair estimate of the capitalization of the appellee the following elements should be considered:

In about 1895 the Brooklyn Union Gas Company purchased the five subsidiaries above mentioned for

a total cost of $5,846,530. This cost was apportioned as follows:

| *Bonds* | *Cost to B. U. G. Co.* | |
|---|---|---|
| Newtown Gas Company | $1,695,000. | |
| Jamaica Gas Light Company | 342,000. | |
| Woodhaven Gas Light Company | 320,000. | |
| Flatbush Gas Company | 2,865,000. | |
| Total Bonds | | $5,222,000. |
| *Stocks* | | |
| Flatbush Gas Company | $372,771.64 | |
| Newtown Gas Company | 60,000. | |
| Richmond Hill & Queens County Gas Light Company | 26,758.86 | |
| Jamaica Gas Light Company | 145,000. | |
| Woodhaven Gas Light Company | 20,000. | |
| Total Stocks | | 624,530.50 |
| Total cost of subsidiary securities | | $5,846,530.50 |

(P. S. C. Report 1923 in evidence.)

Deducting, therefore, the actual cost to the plaintiff company of its subsidiaries from its total outstanding securities, as found by the Master, in the amount of $46,579,000, leaves a balance of $40,732,469 as the outstanding securities applicable to its own property including the portion of the property devoted to the use of the subsidiaries.

The Master has found 10% as the fair allocation of the amount of property devoted, to the use of the subsidiaries. Allowing this amount, although the appellant contended for 12%, a further deduction of $4,073,246 must be made. This leaves a balance of $36,659,223.

From this figure, however, an amount of about $3,000,000 (p. 849) ought to be deducted for loans and accounts owed by the subsidiaries. Such loans are made by the parent company out of funds obtained by the sale of parent company obligations. This deduction leaves a balance of about $33,500,000 as a fair and equitable estimate of the outstanding

securities of the plaintiff company for the purpose of rate making.

This figure of $33,500,000 coincides very closely with book cost of $29,000,000 as indicated above if an addition of $3,000,000 is made for working capital. While it seems to be settled that neither the market value of the outstanding securities nor the par value is a controlling indication of fair value for rate making purposes, nevertheless that capitalization is a factor to be considered and is particularly worthy of consideration where, as in this case, it bears out so closely the actual investment.

**Reproduction cost new is only one of the elements to be considered in fixing fair value for rate making purposes. The Court below erred in using it as a controlling and predominant element.**

As previously pointed out, fair value is arrived at by consideration of a number of elements, original cost, book value, actual investment, outstanding securities, the history of the company, reproduction new, depreciation, etc. *Smyth* v. *Ames*, 169 U. S., 466, supra; Minnesota *Rate Cases*, supra, San Diego v. National City, 174 U. S., 739, etc.

Reproduction cost is but one of the factors, and that it is not a controlling factor is evident from an examination of recent decisions of the Commissions and the courts. This is particularly so since the World War brought about the enormously inflated prices. This violent rise in prices of materials, and labor, presented a new and serious problem in rate litigation.

One of the first cases to be passed upon by the courts, during the unusual upheaval of prices, was the *Brooklyn Borough Gas Company* v. *Public Service Commission*, P. U. R., 1918-B, page 335.

Ex-Justice Charles E. Hughes was the referee (he had written the decision in the Minnesota Rate Cases) and said:

> "While it is important to consider the cost of reproduction in determining the fair value of a plant for rate making purposes, it cannot be said that there is a constitutional right to have the rates of a public service corporation based upon the estimated cost of the reproduction of its property at a particular time regardless of circumstances. To base rates upon a plant valuation simply representing a hypothetical cost of reproduction at time of abnormally high prices, due to exceptional conditions would be manifestly unfair to the public, and likewise to base upon an estimated cost of reproduction far lower than the actual bona fide and prudent investment because of abnormally low prices would be unfair to the company. * * *"

Following this decision of Judge Hughes, the general tendency of the Public Service Commissions throughout the United States was to avoid reproduction prices new at inflated war figures.

A careful investigation of the recent cases which have come before this Court shows that in none of the cases was the reproduction new valuation adopted by the Court, though such a contention was made.

In the case of Missouri ex rel. Southwestern Bell Telephone Co. v. P. S. C., 262 U. S., 276, the following valuations were before the Court for review (pp. 282, 283):

| | |
|---|---|
| (1) Valuation adopted by the Commission ..... | $20,400,000 |
| (2) Cost as shown by the books .... | 22,888,943 |

(3) Reproduction new as of June 30, 1919 ..... 35,100,868

(4) Reproduction new, less depreciation ..... 31,355,675

With these various elements of valuation bearing upon "fair value" for rate making, this Court remarked (p. 288):

> "Witnesses for the company asserted—and there was no substantial evidence to the contrary—that excluding cost of establishing the business the property was worth at least 25% more than the Commission's estimates, and we think the proof shows that for the purposes of the present case the valuation should be at least $25,000,000."

Here this Court indicated its judgment that "fair value" was a sum $6,000,000 less than the reproduction new, less depreciation of the property, and $10,000,000 less than the reproduction new valuation.

It will be noted that "fair value" as fixed by the Court in this recent case was about 9% *over book cost, about* 20% *less than reproduction cost less depreciation and about* 30% *less than reproduction cost without depreciation.*

Another case to come before this Court at about the same time was the Georgia Railway & Power Co. case, decided June 11, 1923 (262 U. S., 625).

In this case the following elements of value were before the Court:

(1) Value adopted by the Commission, $5,250,000;

(2) Company's reproduction valuation at 1921 prices, $9,550,000.

In that case the company asserted that the rule to be applied in valuing the physical property is the cost of reproduction at the time of the inquiry, less depreciation.

This Court as indicated in the excerpt from its opinion above quoted found that no error was made in the Commission's finding. Yet the Commission's finding was practically original cost or reproduction cost at 1914 prices plus a small allowance for going value. The decision in this case is particularly important here as the company involved was a gas company whose plant was somewhat smaller than that of the Kings County Lighting Company.

It would seem clear from this decision and that of the Southwestern Bell Telephone Company (supra) that this Court is far from holding, as contended by appellee that reproduction new without deduction for depreciation is the predominant factor in determining rate base.

Yet the Master in the instant case evidenced a "slavish adherence" to the cost of reproduction and in addition his reproduction cost makes no deductions for depreciation or only most negligible ones for current maintenance. His "fair value" estimate is *only about* 13% *less than his reproduction new without depreciation estimate and is almost* 70% *higher than the actual original cost of construction of the plaintiff's property.*

The appellant also contends that the estimates of reproduction value as found by the Master were excessive and unsupported by the evidence. This contention we shall next go into.

**The estimate of the reproduction cost of the appellee's properties as found by the Court and Master are excessive. The cost of reproduction should not have exceeded $33,-992,000.**

The Master found the following elements and estimates in arriving at reproduction cost (Master's Opinion, p. 118):

| | |
|---|---|
| Land | $ 3,000,000 |
| Manufacturing plants stations and holders | 14,500,000 |
| Building and structures other than manufacturing plants and stations | 7,000,000 |
| Mains | 18,000,000 |
| Services | 6,250 000 |
| Meters | 4,000,000 |
| Overhead and financing | 11,000,000 |
| Equipment | 600,000 |
| Total | $64,350,000 |

The Court accepted these estimates except that it deducted $549,124, the amount found by the Master as necessary to restore the properties "to a condition equal to new" (p. 226). The Court's estimate of reproduction value was therefore $63,800,876.

## Manufacturing Plants, Stations and Holders:

Colonel Miller, appellee's expert, testified that the cost to reproduce these properties would be $15,-113,000 and that it would cost $528,000 to restore them to a condition, equal to new (Pltffs. Exs. 283, 284, p. 1955). The Master apparently took the witness's figure in toto, finding a value of $14,500,000, although in his opinion (pp. 62-64) he admitted that

some of the holders were constructed 50 years ago; in some instances even longer ago. The Court followed the Master except as hereinbefore indicated.

Col. Miller's company, the Bartlett-Hayward Co., has installed 80% of the storage capacity of the appellee and its subsidiaries. It has built 95% of the gas generating apparatus and purifying condensers used in the Brooklyn Union Systems except the Equity plant, etc. His company was continuously doing work for the plaintiff (p. 1054). This statement is made to indicate the unquestioned bias of the witness.

Included in his estimate are 27 old gas holders all installed by the vendor companies from 1851 to 1892. The witness calculates the cost to reproduce these to be $2,739,000. They have a capacity of 12,207,000 cu. ft. The estimate is therefore at the rate of over $.22 per cu. ft. This is an exorbitant price as is shown by the price of recent installation of similar holders. In 1923 the Brooklyn Union Co. built a holder at Fifth Street having a capacity of 5,000,000 cu ft. at a cost of $438,413, or at the rate of .08768 per cu. ft. (for above figures see table infra, p. 79). This figure applied to the holder and capacity of these old holders would give a cost to reproduce without depreciation of only $1,069,696 as against Miller's figures of $2,739,000. If the holder capacity of the company were to be reproduced on June 1, 1923, it is evident that the 30,957,000 cu. ft. capacity could be reproduced at a cost not to exceed $2,714,309. This would fairly represent the cost of new holders, whereas the old holders are on an average some 30 years old and necessarily depreciated in a marked measure. His figures resulted in an estimate of reproduction value for old and obsolete holders three times as large as it cost the company to build new and up to-date holders in 1923.

The witness in reaching his estimate of what it would cost to put the property in a condition as good as new did not consider the age of property (p. 1133); he made no allowance for inadequacy of obsolescence (p. 1133). He admitted equipment and apparatus becomes inadequate, etc. (p. 1133). The record (pp. 1132, 1133), shows that he included in his estimate specific items of property which had actually been removed. And when asked if he would have made any other estimate for reproduction cost if he had known that this property was removed he answered "No," and said

> "The same answer would apply to any other piece of apparatus which I have appraised but which has been removed since that date" (p. 1133).

The Court should and must in all fairness take judicial notice that under all the circumstances a figure of $528,000 for depreciation of these properties is so inadequate as to become absurd. Indeed it does not even purport to be a measure of depreciation but only the cost of necessary current repairs and renewals. Argument upon this will be set out in greater extent in our point on depreciation in this brief and in the brief in the Consolidated case.

It was upon the basis of this witness's testimony taken exactly in amount as it was given that the Master found $14,500,000 for the reproduction value of manufacturing plants, stations and holders, and the Court allowed about $14,000,000.

All in all the reproduction value of these properties should not exceed $12,000,000. It is probably much less. The saving in the old holders alone is not less than $2,000,000. An estimate of $1,500,000 for depreciation, or about 12%, is cer-

tainly moderate for apparatus which has existed for so many years.

**Buildings and structures other than manufacturing plants and stations.**

The Master found a reproduction value of $7,000,000 for these items. The Court accepted this figure less $20,756, the amount that the company witness testified would be necessary to expend to put these properties in a "condition equal to new" (p. 226). The Master admits that the evidence on this subject is somewhat perplexing (Master's Opinion, p. 53). Mr. Burt, a real estate expert called by the plaintiff, fixed the reproduction value at $7,149,685. He placed a value of $4,354,549 upon buildings at the works and a reproduction value of $2,795,136 for buildings outside of the works (Plaintiff's Exhibit 171, p. 1686, (fol. 2533). He further testified that it would only require an expenditure of $20,756 to restore these buildings to a condition equal to new (Plaintiff's Exhibit 172, p. 1688).

The principal buildings outside of the works consist of some nine buildings; a general office building, a demonstration building, several warehouses and several branch buildings, a fitter's school, and a laboratory. The record discloses that Burt's valuation of these buildings totaled $1,740,000, while the City's assessors, in assessing these same buildings for the year 1923, placed a valuation upon them of $660,000. As the Master points out in his opinion (p. 54) there is a great disparity here, "almost three to one." It was the duty of the City's assessors, under Section 889 of the Greater New York Charter, to place an assessed valuation upon property at "an estimate of the sum for which under ordinary circumstances, the same parcel of real estate would sell with and without improvements."

We submit to the Court a comparison of the valuation of buildings outside of the works, as appraised by witness Burt and the City's appraisers.

| | | | |
|---|---|---|---|
| 1. | General Office bldg., 176 Remsen St. | $1,026,099.28 | $447,000.00 |
| 2. | Demonstration bldg., 180 Remsen St. | 135,337.21 | 22,000.00 |
| 3. | Warehouse, 130 Atlantic Ave. | 56,345.01 | 7,400.00 |
| 4. | Warehouse Garage, 1016 Fulton St. | 30,131.67 | 14,000.00 |
| 5. | Nassau Branch, 1024 Fulton St. | 219,419.73 | 83,500.00 |
| 6. | Metropolitan Brch., 5th Ave.& 8th St. | 73,576.38 | 24,500.00 |
| 7. | Williamsburgh Brch., 322 Bedf'd Ave | 117,529.92 | 40.500.00 |
| 8. | Fitters School, 197 St. James Place | 34,210.24 | 8,650.00 |
| 9. | Laboratory and Medical School, 191 St. James Place | 48,273.90 | 12,650.00 |
| | Total | $1,740,923.34 | $660,200.00 |

The Master and the Court accepted Burt's figure for reproduction value almost as the witness gave it.

It is difficult to estimate the present value of old gas buildings from the present cost of erecting new buildings of the same character. It is significant to note that Mr, Burt testified that it would cost $1,026,000 to reproduce the office building (Plaintiff's Exhibit 171A). Later Mr. Greve, a company witness, testified that the fair market value of both the land and the same building was $800,000 (p. 1048). He had previously testified that the land on which the office building stood was worth $215,000. Here is a startling and concrete instance showing the inflated figures submitted by the plaintiff in an attempt to establish an exorbitantly high reproduction value. Mr. Burt's estimates made no allowances for depreciation. He treated the buildings as new although he admitted that a new building is comparatively immune from repairs for the first four to eight years (p. 634). He stated that up to the very moment of its retirement or abandonment he would estimate a building or structure at its full reproduction cost and even though he knew that a building was about to be removed,

he would estimate it at its full reproduction cost (p. 638). His idea of depreciation is well exemplified by a citation of a single instance. He testified that the reproduction cost of purifier house A at the Williamsburgh Works was $106,762. He testified that by patching a metal Louvre over the door, at an expenditure of $5, the building would be as good as new though it was about four years old (p. 639). This was his idea of the necessary depreciation to be applied upon this item. He did admit, however, that in making out his own personal income tax return he had deducted a certain amount of depreciation annually on brick buildings (p. 645). Another instance was found in the buildings at 1116 and 1124 Fulton Street. The witness testified that they needed no repairs at all and were in excellent condition. He was asked whether he knew that the company itself had spent some $7,000 in making repairs on this building after June 1, 1923 and said that he did not (p. 635).

As to this fact the Master in his opinion says.

> "Upon cross examination, there was a suggestion in the form of questions propounded to the witness to the effect that while Mr. Burt's valuation was as of June 1st, 1923, the plaintiff had, as a matter of fact, between June 1 and December 31, 1923, spent approximately $7,000 in repairs upon the buildings 1116 and 1124 Fulton Street (p. 2170), and substantially a like amount upon repairs to the building 176 Remsen Street (p. 2172), although the witness had testified that the latter building required an expenditure of only $380 (Plaintiff's Exhibit 172). Whether or not such expenditures as were thus suggested by the questions were as a matter of fact incurred by the plaintiff, does not specifically appear, except

from an examination of plaintiff's books of account in evidence. These books do not sustain the suggestion embodied in the questions, although they indicate that repairs were made subsequent to June 1st, 1923. Mr. Burt testified that at the time of his examination some repairs were in process of installation, and I interpret the testimony of Mr. Burt as substantially to the effect that in making his valuations and estimates he deemed the repairs then in progress as having been carried to completion" (p. 53).

As a matter of fact the books sustain exactly the contention made. It was conceded to be so by counsel for plaintiff-appellee and the books do show that such an amount of repairs were made. The Master's peculiar circumlocution, in fact, does not deny it. As to the office building Mr. Burt himself said such an expenditure was "very likely" (p. 636). Neither is there any justification in the record for his statement in the last sentence above quoted that Mr. Burt "in making his valuations and estimates deemed the repairs then in progress as having been carried to completion." Mr. Burt's testimony was that he visited all of the buildings in the first week of June, 1923, and stated that "if everything mentioned in this exhibit No. 172 were done *on June* 1, 1923, everything that had occured by way of progressive deterioration prior to June 1, 1923, would have been supplanted by replacements equal to new and in addition to that, further progressive deterioration would be arrested" (p. 632). The Master's finding in this regard seems another evidence of an attempt to justify an unjustifiable refusal to reduce the valuation of plaintiff's property.

In view, therefore, of the excessive values placed

by Mr. Burt upon buildings in comparison to assessed values and the fact that the amount allowed for depreciation is almost negligible, it is fair to assume that the reproduction value of buildings and structures does not exceed the sum of $5,000,000. It is probably much less.

## Mains.

The Master allowed $18,000,000 for this item. The Court accepted this figure without change (p. 225). Mr. White, plaintiff's officer in charge of mains, testified to an aggregate reproduction cost of $19,073,000 for mains, including $1,043,000 for "pavement disturbed for construction" (Plaintiff's Exhibit 164, p. 1683). The Court and Master made no allowance for depreciation in estimating their reproduction cost of mains (Master's Opinion, p. 58, Court's Opinion, p. 211).

It is further contended that the unit costs, used by the appellee's witness and apparently adopted by the Master, were excessive and exorbitant. The proof offered by Mr. White is particularly vulnerable and fails to carry any degree of conviction, for the following reasons among others:

1. He adopted a market price for cast iron pipe which was purely speculative and based on telephone conversations which mentioned neither amounts needed nor time of delivery (p. 473).

2. He adopted a price for his labor, purely on hearsay and above the rates of wages paid by his own company (pp. 478-481).

3. His estimate of the amount of excavation that would be done by 2200 men in the first 30 or 60 days was difficult of belief and contrary to the knowledge of the most casual observer (pp. 491-495).

4. His estimate included the digging of trenches for pipe, where the pipes were carried over bridges and placed on hangers and over the tops of subways where little or no excavation is necessary (pp. 518, 519).

5. He duplicated trench after trench for long distances, that is, his estimate provided for the digging of a trench for each pipe although the pipes lay close together and in many instances one trench would suffice for several pipes (pp. 544-548) and this glaring error had to be corrected by another witness (p. 56).

6. He duplicated the item for restoring the pavement over a portion of mains and services (pp. 544-548).

1. The testimony discloses that in December, 1923, the company was able to purchase six inch iron pipe at a price $3 a ton less than the price used by Mr. White (p. 472).

2. Mr. White contemplated employing men to excavate and do the other labor as of June 1, 1923. He figured that the men would do a negligible amount of excavation in the first 30 days. Mr. White in his estimate assumed the following costs of labor (p. 478):

A Foreman $1.00 an hour.
Caulkers 87½¢ an hour.
Yarners 75¢ an hour.
Skilled Laborers 68¾¢ an hour.
Common Laborers 62½¢ an hour.

Yet it appears that the Brooklyn Union Gas Company at the very time was paying the following rates of wages:

A Foreman 72¢ an hour.
Caulkers 62¢ an hour.
Yarners 56¢ an hour.
Common Laborers 52¢ an hour (pp. 477, 478).

Mr. White estimated 1¼ inch services at a cost of $32.05 per service and the cost of installing 3 inch services as $76.60. Mr. Payne, the accountant of the plaintiff company, testified that it was the practice of the company to withdraw its 1¼ inch service at a price of $11 a service and its 3 inch services at a price of $42 a service. In accordance with the uniform system of accounts, the withdrawal of services must be made at the cost of installing the services, if known, and, if not known at estimated cost. It is very apparent that Mr. White has greatly over-estimated the cost of both installing services and mains. It would be an endless task to go into detail as to all his inflated costs. These several examples are typical and are given to the Court so that it may properly apprize the value to be given to the testimony of Mr. White. We have in the books the actual cost of installing mains in and about June, 1923, and these surely are a safer and truer guide than Mr. White's exorbitant estimates.

It appears from the company's own records that the average cost of installing mains in June, July, and August, 1923, is as follows (Master's Finding 81, p. 114):

| Size of Main | Cost Per Foot |
|---|---|
| 2 | .85 cents |
| 4 | $1.48 |
| 6 | $1.72 |
| 12 | $2.31 |

Plaintiff's Exhibit 164 (p. 1683) shows the number of feet of the respective sizes of street mains used by the complainant on June 1, 1923. Applying the unit costs, as shown actually by the appellee's books and comparing them with Mr. White's estimate of reproduction cost of these sizes, we note the following startling differences:

| Size of Main | No. of Feet | Cost | Total Cost | Mr. White's Estimate |
|---|---|---|---|---|
| 2 | 22,663 | .85 | $ 19,263.55 | $ 21,140.05 |
| 4 | 1,631,512 | 1.48 | 2,414,637.76 | 3,105,909.39 |
| 6 | 2,002,242 | 1.72 | 3,443,856.24 | 4,862,845.14 |
| 12 | 478,964 | 2.31 | 1,106,406.84 | 2,443,386.95 |
| | Total..... | | $6,984,164.39 | $10,433,281.53 |

It should be borne in mind also that the foregoing average costs represent only piecemeal construction in various localities. If all of the construction work of mains were to be done at one time, if such a situation could be conceived, even these costs would be excessive. It must be very apparent that Mr. White's estimates of present cost of reproducing mains is exorbitant. Taking into consideration, therefore, a deduction for disturbing pavements, as hereinbefore pointed out, and the excessive unit prices used by Mr. White, etc., it is apparent that his estimate is more than double what it would actually cost to install the mains of the plaintiff company, less the necessary depreciation. A figure of $10,000,000 would be far higher than a fair estimate of reproduction cost of mains.

Mr. White indeed showed himself to be a ready calculator and his calculations of reproduction cost of mains could be and were modified to fit the case. In October, 1919, he estimated the reproduction cost of 1,013 miles of main at $6,567,070 without overheads and using prices as of 1914 (pp.

592, 598). In 1923, he estimated for the sworn report to the State Tax Commission that the "value of mains in the streets as of December 31st, 1922, was $8,080,759.78" for 1042 miles of main. He added 10 per cent. for general contractors' expenses and 12 per cent. for interest, engineer, taxes, and insurance during construction, making a total replacement value of $9,955,496.05 (pp. 596, 598). In 1923, for the purposes of the preliminary injunction in this case, he made an affidavit that the mains, which he now says it cost $19,073,209.83 to reproduce, would have cost only $16,206,284 on January 1, 1923 (p. 599). The first estimate was for January 1, 1923, and the second was for June 1, 1923.

Obviously, like most reproduction value experts, Mr. White is prepared to increase his estimate of the value of the property as the cost of making gas goes down. It seems quite apparent that the plaintiff should not be allowed more than they reported to the Tax Commission for this item, as the cost of reproduction of these mains. $10,000,000, which is far higher than the book cost of the mains is certainly ample.

The book value figure for mains is about $10,000,000, but this figure includes $4,000,000 or $5,000,000 testified to by Staniford before the Stevens Committee for rights in the streets (p. 794). The net book cost, therefore, is between $5,000,000 and $6,000,000 without depreciation. It is common knowledge that prices of construction today are not more than 50 per cent. over what they were when the average main of the Brooklyn Union Gas Company was laid while improved and more economical methods of construction would very largely compensate for higher labor and material prices.

Mr. White admitted finally on cross examination

that if he were actually going to reconstruct the main system he would not go about it as his estimate was made up saying (p. 560): "If I were going to actually reconstruct the system I would put my services in at the time of the laying of mains but I am not going to actually reconstruct the system, consequently I would not do it."

In reality he had no conception of what he was trying to do nor of what he would have to do if he knew what he was trying to do. He was a pitiful witness giving estimates that were mere exorbitant guesses and unable to justify them when pressed under cross examination.

SERVICES:

The Master found this item in the amount of $6,250,000. The Court accepted the figure (p. 225). Appellee's witness, this same Mr. White, estimated the cost to reproduce services at $6,256,506.65 (Plaintiff's Exhibit 165). Despite the fact that the Master concludes that "not all of the expense of installing these services has been borne by the plaintiff, a contribution has been made by some consumers in some cases" (Master's Opinion, p. 58), yet no allowance is made for this by the Master (Opinion, pp. 59, 60), nor by the Court (p. 212).

In the early history of the gas business, it seems that the company frequently charged the consumer for the cost of installing the service pipes. The minutes of the Williamburg company show that a notice was published, that on and after December, 1851, consumers would be charged for the cost of services installed and the Master so finds (Finding 90, p. 113). The books of the Metropolitan Company show receipts of cash from consumers for the cost of installing service pipe (Finding 91, p. 114) and Mr. Staniford testified (p. 1310) that it was

the custom to charge the consumer $10 for each service and in the event that there was improved pavement, an extra charge was made for that (p. 1310) down to about the year 1894 and furthermore to charge contractors the actual cost of such installation (p. 1310).

The Brooklyn Gas Light Co., according to a resolution of Board of Directors charged the consumers for service in excess of 13 feet from the curb.

It is clear that many service pipes are not owned by the company, but by the householders, who have paid for them and across whose property they have been placed. Certainly, the company could not remove them from the property of the consumer and certainly the consumers paid for them or part of them.

While it does not dispute that the consumer contributed to the cost of installing many of the service pipes, still it claims an 8% return upon the value of that property, owned by the householders. A mere statement of such an unfounded claim should be enough to demolish it.

Regarding the payment made by consumers for the installation of service pipe, Mr. White testified, after refreshing his recollection, as follows (p. 552):

> "During the time that I have been with the company, from 1910 to 1919, there was a certain amount charged, a part of the installation, a part of the cost per foot, and from March 20, 1920, to the present they have been charge a different sum. From 1912 to 1920, for 1¼ inch pipe, I charged them 15 cents per foot; for inch and one-half pipe, 15 cents per foot; for 2 inch pipe, 25 cents per foot; for 3 inch pipe, 50 cents per foot. From March 20, 1920, to the present time, to June 1, 1923, 1¼ inch pipe, was 60 cents per foot; 1½ inch, 65

> cents; 2 inch, 80 cents, and 3 inch, 95 cents, it being understood that these prices were charged for that part of the service pipe on the private property of the consumer or, in other words, within the lot line."

The Master asked that the extent to which the consumers had paid for the service pipe be covered by an agreed statement of fact in the case, but no attempt was made by appellee to reach any such agreed statement.

Mr. White testified further as follows (p. 551):

> "That portion that the consumer has paid for is included within the 41 feet that I have assumed as an average distance."

In other words, Mr. White's estimate includes the present cost of again installing the service pipe on the premises of the consumer, for he adopts the average length of 41 feet for such service pipe. The company should have been compelled to show the extent to which the consumers had actually contributed for the installation of service pipe, so that the Master could have excluded such portions of the service pipe actually paid for from any determination of fair value of property owned by the company, for the company does not, in fact, own such service pipes.

The Court apparently took a strained and technical view point in the matter. It said (pp. 212, 213):

> "No finding deducting anything from the item for Services when the same were laid on the consumers' property inside the building line can be based on the fact that some consumers had contributed an amount which was not definitely shown on account of the whole

> expense of installing services, because that would not be a proper deduction, the only deduction that could properly be made would be the value of the property, if any, included in that item which belonged to the consumers, and no testimony was offered to prove that title to any was in the consumer. The testimony shows that all replacements of services were made at the expense of the company, and there is no proof of their intention to give them to the consumer when they were laid on the consumers property at his invitation and with his license."

The force of this reasoning does not appear. We are not here trying title to service pipes. We are in a Court of Equity endeavoring to ascertain the value on which this company should receive a return. Whether consumers obtained title to the pipes they paid for is not important. It is important that they should not be required to pay interest on their own money.

Mr. Payne, the auditor of the complaint, testified (p. 1014) that there were no books or records showing the cost of installing the services. He said (p. 1014):

> "We withdraw our services at a certain stipulated regular price—when a service is withdrawn there is a certain price per foot, according to the size. The ¾ inch services are withdrawn at $10 per service; 1¼ inch services are withdrawn at $11. The 1 inch services are withdrawn at $10. The 1½ inch are withdrawn at $15 and the two inch are withdrawn at $20.

Mr. Payne further testified as follows (p. 1016):

> "In the year 1922 we received cash from

consumers in the amount of $21,697.02 for services. In 1923 we received cash from consumers in the amount of $19,573.58. Both of those amounts, of course, have been credited to the service account. I cannot secure the amount of the contributions made by the consumers in prior years because it required a great deal of analysis to go into the different credits to that account. *That is the only reason.*"

He further testified:

"Our records show that it was always the custom to charge the consumer for the average length of pipe from the house line to the meter. It is our custom to charge the consumer from the house line to the meter and in order to get the total amount contributed by the consumer, we would have to make a careful analysis of all the credits and all the debits to our service account and that would be a tremendous job" (p. 1017).

The Uniform System of Accounts (Ex. 244, p. 1720) provides (Section 20):

"Withdrawals or retirements—When anything is withdrawn or retired from service, the amount at which such things stood charged in the capital account shall be credited to the capital account in which it stood charged at the time of withdrawal, and the entry of such credit shall cite by name and page of book or other record the original entry of cost of the thing withdrawn. If there is no such original entry, that fact shall be stated in connection with the credit entry and the actual amount originally charged shall be credited. If such

amount is not known, it shall be estimated, the facts upon which the estimate is based shall be shown, and the amount thus estimated to be the original charge in respect of such thing withdrawn shall be credited."

According to the provisions of the Uniform System of Accounts, which appellee contends it complies with, it will be seen that it was the duty of the company to withdraw the services at the actual cost of installation of such service, if known; and if not known, the services were to be withdrawn at prices estimated to be the actual cost of such installation.

The Uniform System of Accounts further provides as follows (p. 1731):

(232—GAS SERVICES.)

"Charge to this account the cost of the corporation's property in service pipes and appurtenances in or leading to consumers' premises. This includes the cost of material in place, cost of trenching for placing services, and of filling trenches and of restoring surfaces to proper condition.

"NOTE A.—When consumers are required to pay some or all of the cost of services, *only that portion of the cost not chargeable to the consumer is chargeable to this account;* and in all cases where only a portion of the cost of the service is chargeable to this account, the entry in this account shall show the entire cost of the service, as well as the amount charged to this account."

In other words, the Uniform System of Accounts provides that where the consumers contribute a portion of the cost to install services, the books of

the company should show the complete cost of installation of the services, together with the amount which is properly chargeable to the fixed capital account or that portion of the services paid for by the company.

It will be seen from the above provision that the books of the company if kept in accordance with the uniform system of accounts, should contain the data regarding the amount contributed by consumers in the installation of services, and that portion of the service which the company actually paid for. The question, therefore, is whether the company should be rewarded for its failure to keep its books lawfully by having its valuation increased. The Court and Master apparently think so for one of the excuses for not doing justice in this matter is that the amount to be deducted does not appear (p. 59). As a matter of fact Payne, we have seen, states that it is in the books and the only reason he couldn't state it is that it would be a difficult job to find it. One thing or another is true. Either the books show the amount in a manner easy to find as required by the Uniform System of Accounts or they do not. In either case the company is at fault and the consumers should not suffer. The Court should have either thrown out the entire item or should have made a substantial deduction of not less than one-third.

**The reproduction value is excessive as shown by the Company's own books.**

The Courts and Commissions are and have been unanimously opposed to this unjust inclusion:

> Arkansas Water Co. v. City of Little Rock, Fed. P. U. R. 1924C, 73 at 100;
> Bothwell v. Consumers Co., 13 Idaho 568, 92 Pac. 533;

Hatch v. Consumers Co., 17 Idaho 204, 104 Pac. 670;

*Re*—Peekskill Ltg. & R. R. Co., P. S. C. Reports, N. Y., Vol. II, 265, 273; P. U. R. 1923C, 169;

Simpson v. Buffalo Gas Co., 2 P. S. C. 2nd Dist. N. Y. 531;

Rogers v. Nassau & Suffolk Ltg. Co., 9 P. S. C. 2nd Dist. N. Y., 321; P. U. R. 1920E, 132;

Water Protest Co. v. York Water Co., P. U. R. 1924C, 680;

*Re*—Atlantic County Water Co., P. U. R. 1923E, 353;

*Re*—Clementon Spring Water Co., P. U. R. 1922B, 856;

*Re*—Dakota Utilities Co., P. U. R. 1920F, 919;

*Re*—Illinois Northern Utilities Co., P. U. R. 1920D, 979;

*Re*—Bluffton Municipal Light and Water Works, P. U. R. 1919E, 117;

*Re*—Monmouth County Water Co., P. U. R. 1919E, 747;

*Re*—Champaign & U. Water Co., P. U. R. 1919E, 798.

By reference to Complainant's Exhibit No. 165 (p. 1684), there will be found the number of services in the ground and the size of the various services. By applying the cost, as shown by the withdrawal figure to the various services now in the ground, we have a fair measure of their original cost, as follows:

| Size | Number in Ground | Cost as Withdrawn | Total Cost |
|---|---|---|---|
| ¾" | 7,676 | $10.00 | $ 76,760.00 |
| 1" | 13,117 | 10.00 | 131,170.00 |
| 1¼" | 85,694 | 11.00 | 942,634.00 |
| 1½" | 34,468 | 15.00 | 517,020.00 |
| 2" | 5,722 | 20.00 | 114,440.00 |
| 3" | 854 | 42.00 | 35,868.00 |
| 4" | 119 | 62.00 | 7,378.00 |
| 6" | 28 | No evidence of cost of withdrawal | |
| 8" | 7 | (do) | |
| 12" | 2 | (do) | |
| | 147,687 | | $1,825,270.00 |

This figure approximates very closely the amount at which in 1919 he estimated the reproduction cost of the 141,616 services, $1,868,298 (p. 592). In 1923 he estimated for the sworn report to the State Tax Commission for the year 1923 that the value of 146,691 services as of December 31, 1922 was $3,639,152.15 (p. 598). In 1923, for the purpose of the preliminary injunction in this case he made an affidavit that the 146,691 services would have cost $5,069,310 as of January 1, 1923 (p. 599). It is hard to reconcile the above estimates with his figure in this case of $6,256,506.65 for 147,687 services.

In view of this great disparity between White's estimate and the withdrawal cost, and further the contribution by consumer's to the installation cost and considering also that the Court and Master erroneously included cost of disturbed pavement in their estimate it is fair to assume that $4,000,000 would be far more than the reproduction cost of services less depreciation.

## Meters.

The Master found the reproduction cost of this item at $4,000,000. The Court accepted this figure also (p. 214). Appellee's evidence showed that the company had 487,745 meters in use on June 1, 1923, and that the cost of these meters new on that day would be $4,550,000 (Pltf.'s Ex. 166, p. 1685).

There is nothing in the record which shows more clearly than this the Master's overwhelming aversion to reducing the valuation of the company's property unless incontestable proof as to the exact amount of deduction is presented.

The testimony as to the short life of meters and that the depreciation in meters is material is conclusive. Donald McDonald, of the American Meter Company, testified as follows:

> "In my opinion the life of a gas meter is about thirty-three years. My present opinion is that it is longer than 25 years and my best opinion now is that it is about 33 years" (p. 1042).

He said that every company was constantly studying its own product and

> "as a result of that study I came to the conclusion that the life of a gas meter, the useful life was about 33 years" (p. 1044).

And again:

> "In stating the life of a meter as being thirty-three years, I meant a meter which was being kept in good repair, The life of a meter, if not kept in good repair, would be much shorter than thirty-three years I should say" (p. 1045).

And again:

> "Q. They will last on the average about thirty-three years, even if kept in a good state of repair? A. If kept in a good state of repair" (p. 1047).

This last bit of testimony was practically a final expression of the witness on this subject after he had been cross examined by counsel for the appellee in an endeavor to show that meters never wear out.

This testimony of Mr. McDonald, which is entitled to the greatest weight, was thoroughly corroborated by the careful analysis of the meter account undertaken by the defendant Public Service Commission. This analysis undertaken by Engineers Wagner and Millar showed that during the years 1913 to 1923, the number of meters withdrawn from service was 56,870, and that the average age of the meters on retirement was 24.16 years (Defendants Exhibit 186, p. 2225). This careful analysis indicates that Mr. McDonald's first estimate of 25 years was more nearly correct than his latter estimate of 33 years. It is probable that what happened between the two occasions when he testified was that some of the attorneys for the gas companies, all of whom are apostles of immortality of gas properties, attempted to convert him to their view. The only testimony to controvert this was the testimony of the Chief Priest of the New Thought School which teaches that things live forever—Colonel Miller. Even he did not attempt to say that a meter would last forever or that it was as good as new when repaired (p. 1067). His testimony as to meters like his testimony as to the cost to make the manufacturing plant new, was really, as we have pointed out, an opinion in the form of evidence that in a rate case the Supreme

Court is wrong and depreciation is not to be considered in a plant which is actually a going concern.

The evidence then is practically conclusive that the life of a meter is from 25 to 30 years, and it follows from this that the present value of the meters of the company cannot be more than 50% of their value, whether that value be taken as the original cost, the cost to reproduce or some value in between. Where a company has been in existence for over 100 years, obviously those portions of its property which have a life of 25 years are at any particular time approximately half of them new. The Master, should, on his reproduction theory, have deducted $2,250,000 for depreciation of meters.

The explanation of his failure to take into account depreciation on meters—it may be said with deference—is very strained. He says:

> "While this evidence leads to the conclusion that depreciation is a factor to be considered in estimating the reproducible value of meters in use June 1, 1923, yet it seems substantially impossible to deduce from this evidence a unit or rate of depreciation which may be safely adopted. The evidence seems not to establish such a unit. It is manifest from the evidence as a whole that at one time wet meters were used; that later on the wet meters were supplanted by the dry meters; that this process was gradual; that some of the meters in use today may be wet meters, but how many is not shown; that the dry meter has more longevity of service; that repairs do not arrest or modify this period of longevity. So far as the evidence before me is concerned, I have no way of determining what portion of the discarded meters were wet meters nor what proportion

were absolutely and utterly destroyed, as by fire or by violence; nor again what proportion were discarded because a larger meter was needed. The evidence does disclose that these reasons exist, but the extent to which they affect this inquiry does not appear.

Another of plaintiff's witnesses, general superintendent of the American Meter Company, estimated the life of a meter to be from 25 to 33 years, although he later stated that while general deterioration takes place, longevity is indefinite and that 33 years is not the life of a meter. Again, he testified that the oldest meter he had ever seen in use was 47 years of age. Upon all the evidence I fix this item at $4,000,000" (pp. 60, 61).

A reading of this in connection with the evidence inevitably gives rise to the thought that the Master is endeavoring to find justification for not making a deduction which the evidence indicates should be made. For instance, what he says to be wet meters is exceedingly far-fetched. The evidence shows that the company began to retire its wet meters as early as 1862 (p. 1255). There is no evidence that wet meters exist today and no reasonable possibility that any of the claimant's meters are wet meters. Again, there is no evidence that any particular meters were destroyed by fire or violence; nor that any meters were discarded because a larger meter was needed. If they were, however, they shortened the average life of the meters. Inadequacy is an element of depreciation. If it existed at all the amount to be deducted for it should have been shown. Again, the Master's analysis of Mr. McDonald's testimony does not seem fair. A careful reading of this testimony cannot leave any fairminded person with the idea that

McDonald said that "The longevity is indefinite and that 33 years is not the life of a meter."

There was a great attempt on the part of appellee's counsel to have Mr. McDonald state the life of a meter was indefinite, but he would not so state, neither did he deny his sworn testimony on cross examination that the average life of a meter was 33 years.

While the Court said nothing specifically concerning the item of meters it did accept the Master's finding of $4,000,000 for this item (p. 225).

EQUIPMENT:

The Master estimated the reproduction value of this item at $600,000. Plaintiff's Exhibit No. 283 placed its value at $653,132. This is the cost of the equipment when new (p. 1955). The equipment consists of automobiles, office furniture, tools and implements. The furniture is old, some very old. The automobiles are used, some very much used. The Court will take judicial notice that property of this character depreciates quickly at a very substantial rate. Witness Miller, for example testified that "an old Ford car say ten years would be just serviceable, in so far as the company is concerned as a new one" (p. 1071). And again he said, "An automobile repaired, that is, an automobile 20 years old, would be as good as a new automobile, if the same is kept in good repair by the replacement of worn parts, it would be just as good as originally" (p. 1070). This fairly sums up the theory upon which reproduction value was estimated and the Court and Master strangely concurred in this theory. We deem comment unnecessary to refute such a patently untenable position. It is safe to say that the reproduction value of this property, less depreciation, is far less than $300,000.

**There is no justification for any allowance for "structural overheads" beyond those appearing in the books and included in so-called investment.**

The Master in calculating reproduction cost allowed $11,000,000 for overheads and financing (pp. 118 and 63, Master's Opinion). The Court accepted the same figures (p. 225). He bases his finding on an allowance of somewhere between 15 and 20% of the estimated reproduction cost, exclusive of meters, for overheads, and 5% for an allowance for the cost of financing.

In computing reproduction cost, some estimate should be made as to the probable expense for overheads, but in arriving at fair value the history of the company in regard to these items as well as in regard to going value is a controlling element. Where, as in this case, the overheads have either been entered on the books or reimbursed out of operating expenses, there is no justification for allowances higher than those shown on the books.

See

Moritz v. Edison Electric T. Co., P. C. R., 1917, A., 364;

Hermann v. Newtown Gas Co., P. U. R., 1916, D., 825.

At page 841 the New York Commission said:

"I took occasion in Bronx G. & E. Co. case, P. U. R., 1916, A., 440, to protest against the arbitrary and what seemed to me grossly excessive allowance for these items (structural overheads) not because it was so important in that case, but because it seemed to me the Commission, by making this allowance arbitarily, was setting a premium on the destruction of books and records of companies in-

volved in rate cases. If any allowance is to be made, there must be some ground for it. * * * As regards other overhead expenses, *allowances should be based on actual expenditures and not on theories as to what such expenses might be.*"

In Re Eaton Rapids, P. U. R., 1922-D., 94.

The Michigan Commission said at page 103:

"Certain overhead expenses have always to be met. *Where a record of such expenses is kept, the record is the best measure of what they are.* * * * Our study of the property convinces us that much of the overhead expense was paid as an operating expense from year to year as the additions were made. * * * Where the actual cost of overhead expenses can be found, it seems to the Commission to be a much safer basis than any general rule. It appears to us that in considering this question the history of the way the property grew up should be given considerable attention."

See also

Re New York State Railways, P. U. R., 1922, B., 75;

Re Potomac Electric Power Co., P. U. R., 1917, D., 563;

Re Leadville Water Co., P. U. R., 1921, D., 172;

Re Clarksburg Light & Heat Co., P. U. R., 1917, A., 577.

In the Clarksburg case there was a merger of two companies in 1904. Since the merger the company was prosperous. The Commission said:

"Under the circumstances as they exist in this case, it is the opinion of the Commission

that the items of 'overhead charges' included in the valuation of applicant's plant by said witness should not be allowed."

See also

Buffalo Gas Co. v. Buffalo, 3 P. S. C., N. Y., page 553.

In this case the Buffalo Gas Co. had a small beginning in 1848 and grew with the growth of the City. The Commission said:

"Upon the theory claimed by the company in this case, the engineering and superintendence amount to hundreds of thousands of dollars. To assume that the sum, whatever it may be, is something upon which the company is entitled to a 6% return *is to assume a thing which is unjust and unreasonable in the extreme.* It would make the public in Buffalo pay a return in perpetuity for that which has already been paid for by previous consumers."

Upon the authority of these cases the Court should disregard all overhead charges in the instant case. A recognized authority on utility valuation says:

"The more equitable application of the reproduction method assumes reproduction at present or average prices but under the actual physical conditions and conditions as to overhead expense under which the existing plant was actually and necessarily constructed. *In most cases a company should be able to substantiate its claims for overhead allowances by actual vouchers and other records of such expenses incurred in the construction of the plant.* There is no necessity for leaving this matter entirely to expert opinion as to such

costs, based on somewhat hypothetical conditions of assumed reconstruction."

Whitten on Valuation, page 211.

Since the year 1909, the plaintiff company has been required to keep its books in accordance with the uniform system of accounts as prescribed by the Public Service Commission. This system of accounting makes it necessary for the company to enter in its books of account as part of its fixed capital such expenditures as engineering and superintendence, law expenditures during construction, interest during construction, and miscellaneous construction expenditures and organization. In short, all of the elements that go to make up structural overheads. The company has vigorously contended that its books can be safely relied upon and are to be deemed prima facie evidence of the facts they record. The company claims they have been kept in accordance with the rules and regulations of the Public Service Commission and they have been frequently checked by its representatives. These books since 1909 show the following expenditures for so-called structural overhead items:

| | |
|---|---|
| Engineering and Superintendence... | $123,550 15 |
| Law Expenditures During Construction ..... | Nothing |
| Injuries During Construction..... | 1,707.77 |
| Taxes During Construction..... | 5,503.35 |
| Miscellaneous Construction Expenditures ..... | 655,161.35 |
| Organization ..... | 5,250.00 |
| Total..... | $791.172.62 |

(Finding 48, p. 107.)

All other expenditures actually incurred by the company for so-called overhead items were charged

as operating expenditures and therefore paid for by the consumers. The Court and Master, therefore, in determining fair value should have adopted the expenditures as shown by the books of the company for overheads rather than the exorbitant and unreliable opinion evidence of a paid expert. As was said by the Public Service Commission of the State of New York, in *Re New York State Railway*, P. U. R., 1922, B., page 75 and page 79:

> "When a company has once charged off an item as expense it has reimbursed by the public, which is under no obligations to pay interest upon the item perpetually on the impossible hypothesis that the property is to be reproduced at some one time. The city's estimates for 'overheads' are based on the actual experience of the company, the property of which has been built up gradually, year by year, and they seem reasonable."

Further the Appellate Division of the State of New York, in the case of *People ex rel. Adirondack Power & Lighting Corporation* v. *Public Service Commission*, 200 App. Div., 268; 193 N. Y. Supp., 186, said:

> "The determination as to 'fair value' in each case must depend upon its special facts (citing cases), and we think the Commission was justified in accepting the books as much better proof of the capital actually expended and the present fair value of the property than the estimates and discoveries made by Mr. Cheney"

Not only is this rule adopted by the Public Service Commission and our State Courts, but such a rule was recently followed by Special Master Graham in the New York & Queens Gas case

and in the Consolidated case as well. In these cases the Master rejected all the estimates made by Col. Miller relating to the overhead items and adopted the expenditures as shown by the books of the utility for such items. We contend therefore that in arriving at fair value or reproduction cost, structural overheads should be limited in the instant case to expenditures actually disclosed by the books and the fanciful estimates and far-fetched theories of biased witnesses should not be followed. A mere glance at the claims made by Col. Miller is sufficient to establish their unreliability. Plaintiff's Exhibit 283 (p. 1955) shows the enormous allowances claimed by this witness for overhead items:

| | |
|---|---|
| Omissions and contingencies..... | $ 755,668 |
| Engineering, etc. ..... | 5,471,951 |
| Administrative, etc. ..... | 1,189,097 |
| Interest during construction..... | 5,092,494 |
| Taxes during construction..... | 497,565 |
| Organization, etc. ..... | 4,000,000 |
| Cost of Financing ..... | 4,200,000 |
| Total Undistributed Structural Costs | $21,206,775 |

These hypothetical estimates as compared to the actual expenditures of the company as shown by their books, are so enormously excessive as to shock the conscience of any Court or Master. The books of the company show that since 1909 about $797,000 was spent for structural overhead items. During this period, the company has spent approximately $18,121,423 (Public Service Commission Report for 1923 indicates this figure after deducting $746,000 for land) in structural work, upon which overheads are properly allowed. It is fair to assume that prior to 1909 the same percentage

of overhead expense would have prevailed. Upon this basis the books show that 4.4 per cent. was actually spent for structural overhead items. Miller's figure of $21,000,000 is nearly 100 per cent of actual cost and 40 per cent. on reconstruction new. An allowance, therefore, for this item should not have exceeded $1,200,000, calculated upon the basis of monies actually expended on overheads from 1909 to date, upon the basic figure of $29,000,000, which we contend in Point IV of this brief is the book cost of plaintiff's properties. It would only be $2,068,000 on the Master's figure less land and working capital of $47,000,000. To paraphrase the Appellate Division of our State, this figure approximates a fairer determination for structural overheads, being taken or estimated from the books, than does an enormous and excessive estimate and discovery made by an engineer employed for the purpose of giving just this character of testimony.

It is significant to note also that in the Consolidated case the Master allowed $4,600,000 for "overheads" (Consolidated, Record, pp., 118, 119) for a larger company.

## Summary of Reproduction Costs.

While no concession is made that the reproduction cost less depreciation would be anything approaching the high figures given in the following table yet it will serve as an example to show how grossly excessive the findings in this case are. A summary of the figures suggested in preceding points is as follows:

| | |
|---|---|
| Land ..... | $ 3,000,000 |
| Manufacturing Plants, Stations and Holders ..... | 12,000,000 |

| | |
|---|---|
| Buildings and Structures other than Manufacturing Plants and Stations | 5,000,000 |
| Mains | 10,000,000 |
| Services | 4,000,000 |
| Meters | 2,500,000 |
| Overhead and Financing | 1,200,000 |
| Equipment | 300,000 |
| Total | $38,000,000 |

From this must be excluded the property owned by the plaintiff, but utilized by the subsidiaries. The Master has allowed 10 per cent. for this item. Deducting that from $38,000,000, we arrive at a figure of about $34,000,000 as the reproduction cost of the property of the appellee company, exclusive of working capital.

**The "fair value" of the plaintiff's property giving due consideration to all the elements does not exceed the sum of $35,000,000.**

We have established the following values set out in tabulation as follows:

| | |
|---|---|
| Book Cost | $29,000,000 |
| Actual Investment much less than | 29,000,000 |
| Outstanding Securities | 33,500,000 |
| Reproduction Cost (less depreciation | 34,000,000 |
| Rate Base as Found in the Prior Brooklyn Union Case Plus Additions to Date | 32,927,000 |

Giving all these factors the necessary consideration and the weight that the recent cases seem to indicate the appellant believes that the "fair value" of the plaintiff's property is not in excess of $32,000,000.

To this must be added an allowance of $3,000,000

for working capital making a total rate base of $35,000,000.

This compares favorably with the rate base found by the Master Colonel Graham in the prior Brooklyn Union case in 1921. He found a rate base of $27,916,000 (including working capital) as of Dec. 31, 1919. The additions since that date were $5,569,000 (P. S. C. Reports). At least 10% of these additions are applicable to the subsidiary companies leaving $5,011,000 to be added to Colonel Graham's rate base or a total of $32,927,000.

## POINT II.

**The Court below committed error in holding that no deduction from rate base should be made for accrued depreciation, including inadequacy and obsolescence. The Court erred in placing the burden of proving depreciation upon the appellants. The failure of appellee to make proof of depreciation leaves its case incomplete and constitutes a failure of proof. The case should be sent back for proof on this subject. In default of this a sum of not less than $12,000,000 should have been deducted.**

The appellant contends that the Court and Master erred in not making a proper or, in fact, any deduction for depreciation in the property of the appellee company and have made Assignment of Error accordingly (Assignments of Error Nos. 12, 13, 16, 19-22, 73, 89, 94, Record, pp. 235, 236, 252, 257, 259).

The Master fixed the fair value of the plaintiff's property at approximately $58,000,000.00 (Master's Report, Opinion p. 68). From this

amount he made no deduction for depreciation. He valued land at $3,000,000.00, buildings and structures at $7,000,000.00, after deducting an item of $20,756.00, "the amount necessary to expend in order to put the same in a condition equal to new." The manufacturing plants, stations and holders he valued at $14,500,000.00 after deducting $528,368.00 for "the amount necessary to expend in order to put the same in a condition equal to new"; the mains at $18,000,000.00, services at $6,250,000.00, meters at $4,000,000.00, general equipment at $600,000.00, and overheads at $11,000,000.00. The Court sustained the findings of the Master, in substance, and made no deduction for depreciation (Judge Compbell's Opinion, Record, pp 215, 216), except that the Court deducted $549,124 the amount that the company's witnesses testified would be necessary to expend to restore the properties to a "condition equal to new." Apparently the Court concluded that the Master had not made this deduction although he intended to make it (pp. 213, 214).

In effect, the Court merely made the inconsequentional deduction indicated for "deferred maintenance," and made no deduction whatsoever for decrease in value and future service life due to natural wear and tear occasioned both by use and age, nor any deduction for inadequacy or obsolescence. In fact appellee's theory is that its plant is 100% efficient and that therefore no deductions should be made for depreciation (other than small items for "deferred maintenance"), and both the Master and Court below seemed to have accepted this erroneous theory.

The Court in its opinion said (p. 211):

> "Not only did the defendants fail to call any witnesses to show depreciation, but the wit-

nesses for the plaintiff, as to nearly all items, testified that there was none.

"The properties of the plaintiff are maintained in a high order of efficiency, and that they might have been as good as new for the purposes of the company on June 1, 1923, is not improbable when you consider the narrow line between replacements and repairs, and it must be that parts are being replaced daily and charged as repairs, so that the plant being kept in a high order of efficiency by such replacements, the plaintiff's witnesses do not consider that there is any depreciation.

"The witnesses do in some instance testify to sums necessary to put portions of the property in condition equal to new, and these deductions must be made."

In the instant case, the properties of the Brooklyn Union Gas Company are very old. As outlined previously in this brief, the plaintiff company in 1895 acquired the properties of the then existing seven corporations engaged in serving gas in the City of Brooklyn, to-wit: The Nassau Gas Light Company, The People's Gas Light Company, The Metropolitan Gas Light Company, The Williamsburg Gas Light Company, The Brooklyn Gas Light Company, Fulton Municipal Gas Company and The Citizens' Gas Company. These companies were formed many years ago, as far back as 1849, and operated gas plants, laid mains and services, etc., and much of the property of these constituent companies remain today in the use of the Brooklyn Union Gas Company. Their books show a capital investment in 1895 of about Twelve Million Dollars exclusive of land and franchises (Plaintiff's Exhibit 297, Record, p. 2066), and the opening entry on the books of the Brooklyn Union Gas Com

pany wrote this figure up to Twenty Million Dollars exclusive of franchises and real estate (Exhibit 297, Record, p. 2066). Obviously, property of this age must necessarily be depreciated in value.

Accepting the latter figure for the purpose of this argument it would appear that at least $13,000,000 of this property or approximately two-thirds is still in existence. During the trial of this case, a stipulation was entered into that $4,000,000.00 represented the retirements in this property up to 1909 (Record, p. 1009). The reports of the company for the years 1908-1923 to the Public Service Commission show retirements of about $3,000,000.00, making an approximate total of $7,000,000.00; subtracting this from $20,000,000.00, the figure used by the company as the value of the acquired property, leaves a balance of $13,000,000.00, representing the company's value of property still in use, and at least thirty years old; keeping in mind that the constituent companies started their operations during the period from 1849 to 1878, it would be safe to assume that this property still in use has an average age of from forty to fifty years. No argument is necessary that such property is not as good as new, no matter how well it has been kept in repair.

The amounts given by the two witnesses of the company as cost to restore equal to new and which the Court took great care to deduct are so infinitesimal as any measure of real depreciation that counsel for the company, Colonel J. A. Dyckman, could not but recognize their utter insufficiency. The Master suggested that Burt's figure was plaintiff's testimony as to the depreciation and should be deducted from his valuation. To this Colonel Dyckman answered, *"I only dissented from the word 'depreciation' because it seems to me that the very small outlay, in the opinion of this witness, to put*

*these buildings in the same condition as if new is hardly to be dignified by that long name"* (Record, p. 629). In a moment of unguarded frankness, counsel for the Gas Company *admitted* that his witness' testimony as to cost to restore to a condition equal to new could not be considered by any process of the imagination as a measure of depreciation.

Witnesses Burt and Miller examined the property, estimated its reproduction value and calculated what amounts would be necessary to make certain urgent repairs *that had been neglected.* After these repairs have been made, the property would still be old property—in many instances very old property, subject through the years to wear and tear, inadequacy and obsolescence.

There is no need to repeat here the argument made upon "depreciation" in the brief of the Attorney-General in Ottinger v. Consolidated Gas Co. (pp. 56-57). The situation both on the law and facts are quite similar and we respectfully refer therefore to our brief in the aforementioned case.

We shall set out only a few of the striking examples of inadequacy and obsolescence in this company's property.

In this case, as in the Consolidated there are certain portions of the property which are actually increased in value by reason of age. For instance no holders have been built for over twenty years of less than 5,000,000 cubic feet of capacity (see table on following page). Yet this company has 28 holders of which there are three 72 years old, one 66 and 3 more over 40 years old. The older they are the smaller they are, no less than 13 being of a capacity of less than 500,000 cubic feet. And the older they are the higher the reproduction value per unit of capacity. For example, the three oldest holders of

the company, constructed in 1851, were given a reproduction value by witness Miller of $.303, $.3103 and $.3159 per cubic foot respectively. The two DeGraw Street holders, installed in 1878, were reproduced by witness Miller at $.3792 and $.3783 per cubic foot respectively; the two 5th Street holders at $.2790 and $.3370 respectively. Yet in 1903 the company constructed two large holders at Belmont Avenue and Wythe Avenue on which Col. Miller estimated a reproduction cost of $.099 and $.097 per cubic foot respectively; he similarly estimated at $.1116 per cubic foot the reproduction cost in 1923 of a large holder at 12th Street built in 1904, at $.0947, a larger holder at Berry Street built in 1908 and $.0876 *per cubic foot*, a large holder built in 1923 at Fifth Street.

We annex a table showing the holders taken over by the Brooklyn Union Gas Company in 1895 from the constituent companies, still in use, and the values placed upon them by witness Miller.

| Location | Capacity | Installed | Reproduction Cost | Cost per Cu. Ft. |
|---|---|---|---|---|
| Plymouth St. | 296,000 | 1851 | $ 89,766.08 | .303 |
| Plymouth St. | 299,000 | 1851 | 92,786.65 | .3103 |
| Plymouth St. | 301,000 | 1851 | 95,096.01 | .3159 |
| Front St. | 580,000 | 1867 | 180,117.90 | .3105 |
| Keap St. | 370,000 | 1872 | 89,839.73 | .2428 |
| Skillman St. | 304,000 | 1875 | 88,543.14 | .2913 |
| DeGraw St. | 252,000 | 1878 | 95,559.06 | .3792 |
| DeGraw St. | 284,000 | 1878 | 107,457.28 | .3783 |
| Kent Ave. | 460,000 | 1884 | 118,599.99 | .2578 |
| Skillman St. | 553,000 | | 112,877.92 | .2041 |
| Rutledge St. | 1,056,000 | 1886 | 260,048.01 | .246 |
| 3rd Ave. | 985,000 | 1887 | 193,802.11 | .197 |
| 12th St. | 370,000 | 1888 | 117,510.92 | .3176 |
| Kent Ave. | 1,100,000 | 1888 | 198,405.01 | .1803 |
| 5th Street | 493,000 | 1889 | 137,573.82 | .2790 |
| 5th Street | 245,000 | 1889 | 82,571.74 | .3370 |
| Front St. | 1,146,000 | 1890 | 220,117.19 | .1920 |
| 12th St. | 575,000 | 1891 | 102,797.05 | .1787 |
| Skillman St. | 539,000 | 1891 | 87,000.98 | .1614 |
| Scholes St. | 1,499,000 | 1892 | 180,024.88 | .12 |
| Ashford St. | 500,000 | 1892 | 88,862.83 | .17772 |
| Total | 12,207,000 | | $2,739,358.30 | |

(Ex. 283, p. 1955 and P. S. C. Report, 1923.)

We now submit a table showing the modern, larger holders of the company, installed in the past twenty-five years, and their values as fixed by Miller:

| Location | Capacity | Installation | Cost to Reproduce | Cost per Cut. Ft. |
|---|---|---|---|---|
| Belmont Ave. | 3,250,000 | 1903 | $ 324,627.01 | .09988 |
| Wythe Ave. | 5,000,000 | 1903 | 485,870.47 | .09717 |
| 12th Street | 5,000,000 | 1902 | 558,099.03 | .1116 |
| Berry Street | 5,000,000 | 1908 | 473,986.23 | .09479 |
| Fifth Street | 5,000,000 | 1923 | 538,413.64 | .08768 |
| Total | 23,250,000 | | | |

The first group shows an average reproduction cost, according to Miller, of $.2524 per cubic foot for holders aged 31-72 years as against $.09 per cubic foot for modern holders, and yet *not one cent was deducted for wear and tear, obsolescence or inadequacy of the ancient group! Here there is a disparity of almost three to one in cost to reproduce the old small and undoubtedly inadequate and obsolete holders as compared to the modern ones. Yet neither the Master nor the Court allowed for any depreciation.*

In order to avoid repetition we respectfully refer the Court for additional examples of obsolescence and inadequacy to our brief in this case as follows:

(a) Manufacturing Plant, Stations and Holders (supra, p. 37).

(b) Buildings and Structures (supra, p. 40).

(c) Mains (supra, p. 44).

(d) Services (supra, p. 49).

(e) Meters (supra, p. 58).

(f) Equipment (supra, p. 62).

All of these properties were subject to depreciation, as was shown in our argument, under the various titles, yet neither the Court nor Master made any deductions for this element.

Mr. Burt, an expert called by the plaintiff, who testified to the reproduction cost of the buildings of the plaintiff company, allowed the almost infinitesimal sum of $20,756.00 to restore the buildings to a condition equal to new. It must be apparent that buildings of the character described by Burt, taking into account their age and constant use, must have depreciated in an amount far in excess of this small sum.

The Master during the trial was apparently struck by the inadequacy of Burt's figure of $20,756.00 for "cost to put the building into a condition equal to new," and in response to his query witness said (Record, p. 629):

> "I am not prepared to state, what in my opinion is the amount of depreciation that these buildings have suffered since their erection."

At page 632 the witness testified that his definition of "depreciation" would confine itself to the condition of the building, without reference to obsolescence or inadequacy; that he did not know whether the buildings were adequate or inadequate; that in his view point, "depreciation" was *not* the unexpired useful life of any building; and at page 632 he testified in explaining his Exhibit 171 (the Exhibit giving his "cost to make new"):

> "My theory of depreciation is the sum necessary to expend to make *the current repairs which have been omitted.*"

And again at page 634 he stated that:

> "In this particular case I made no study or

attempt to determine the decreased value or worth, if any, of any of the buildings due to make inadequacy or approaching inadequacy or any element which would lead to its disuse or abandonment by the company."

Again at pages 638, 639 this witness made these significant admissions:

"Even though I knew any one of the structures which I have enumerated in Exhibit 171 was to be removed on June 5, I would in my estimate as of June 1, 1923 have given it full reproduction cost."

Witness Miller's method of estimating reproduction cost and his determined insistence that depreciation does not exist is well shown (p. 1070) in his testimony concerning company equipment. According to the prophet of immortality an automobile, twenty years old, where parts has been kept in repair is as serviceable, as good as new, and should be so valued in a confiscatory case. We are tempted to inquire whether this witness ever tried to sell a used automobile or to "turn one in" as the trade phrase is, for a new car?

Similarly, witness White made no deduction for depreciation in giving his estimate of reproduction cost on mains. The Master and Court adopted practically his figure, allowing $18,000,000.00 for this item. The same is true of services, for which $6,250,000.00 was allowed. Many of the mains and services of the company are very old. While their exact age does not appear, the history of the company indicates that over one-half the mains and services are thirty years old, or over. These are subject to depreciation, as is other property.

In 1905 a Joint Committee of the Senate and Assembly of the State of New York was appointed to inquire into conditions relative to the gas and electric lighting companies of the state. Judge Hughes was made counsel to that Committee. In the course of his investigation, he offered in evidence affidavits of Edwin Ludlam, then Secretary of the Brooklyn Union Gas Co. These affidavits were presented by the Brooklyn Union Gas Co. to the State Board of Tax Commissioners. They show that company's idea of depreciation in their mains and services when the company is valuing their property for tax purposes was quite different than in the instant case.

The secretary of the company, in an affidavit sworn to on the 10th day of April, 1900, said (pp. 2135, 2136):

> "I am the Secretary of the Brooklyn Union Gas Co. and have been since the 21st of November, 1896. * * * I know of my own knowledge and from an examination of the books of the Brooklyn Union Gas Co. that it acquired about 750 (seven hundred and fifty) miles of pipes, etc., in the City of Brooklyn.
>
> Some of the pipes were laid over forty years ago, and from the time that gas pipes were first laid in the City of Brooklyn down to the present day, pipes have been laid from time to time.
>
> *The rust, decay and depreciation of gas pipes, especially by electrolytic action, in the City of Brooklyn is great, and I believe that to get at the present value of pipes, there should be an allowance for depreciation of at least 25%.*"

And again, in the same proceeding, Mr. Ludlam, Secretary of the company, said in a sworn affidavit

to the State Board of Tax Commissioners (p. 2136).

> "There are about 94,000 services connected with the mains of the Brooklyn Union Gas Co. Many were laid forty years ago—and they have been laid all the way down from 1850 to the present time. *They are in all stages of rust and decay*, and, in estimating their value, *a very large allowance must be made for depreciation.*"

Here is the company's own admission of depreciation in mains and services. In a rate case, however, the Company denies the existence of any depreciation. For rate making purposes, its property is immortal—for tax purposes "*in all stages of rust and decay.*"

**The failure of proof by the appellee as to depreciation constitutes an "incomplete case." The case should be sent back for further proof upon this point or in default of this the company's own estimate of $12,000,000 should have been deducted from the rate base.**

*The appellant makes a similar contention in the Consolidated case and we respectfully refer the Court to pages 70-77 of our brief in that case.*

The plaintiff, in attacking the constitutionality of a statute, bears the burden of showing completely, without any missing links in its chain of evidence, that the statute is unconstitutional. A part of its case was to show the "present value" of its property; in attempting to do so, it presented *reproduction cost new*, but did not present any evidence as to the value of the plant in its present condition—that is, it did not present any proof as

to depreciation. To that extent, its proof was "incomplete." Certainly the incompleteness of plaintiff's proof *did not operate to shift the burden of proof upon the defendants although the Court below so indicated* (p. 211).

Since no definite proof was offered by the company relative to the accrued depreciation in its property it is our contention that this failure of proof constituted an incomplete case on the part of the appellee. Proof, however, was offered from the books of the company as to the amount of money accumulated for deterioration, renewals, extraordinary wear and tear, obsolescence, inadequacy, etc., and in default of other proof it may serve here as it has in other cases. The amount so accumulated was $12,589,000.00 on December 31st, 1923 (Master's Finding 59, p. 109). The Court may very well accept this as a fair measure of the depreciation of the company's properties as of this date in the absence of any other proof upon this question.

The development and history of this reserve is revealed by the record to have been as follows (pp. 851-858):

From 1895 to December 31, 1908 an account "Depreciation" was carried and from July 1, 1906, and 10¢ per M sold was credited to this account, withdrawals being charged against it to some extent. January 1, 1909, the balance in this account of $2,382,928 was transferred to an account called "Depreciation and Contingencies" and at the same time an account called "Accrued Amortization of Capital" was opened pursuant to a resolution of the Board of Directors of the company reading as follows:

> "Resolved, that commencing from January 1, 1909, the officers be and they hereby are authorized and directed to charge, each month, as part of the operating expenses of this com-

pany, an amount equal to ten cents per one thousand cubic feet of gas sold each month, *to cover deterioration, renewals, extraordinary wear and tear, obsolescence, inadequacy, replacements, extraordinary casualties, contingencies*, and to cover also, if any of such moneys remain, minor extensions and additions. No charges against the said account or appropriation of the fund, so established, shall be made except by authority of the directors" (p. 853). (Italics ours.)

Under and pursuant to this resolution and modifications thereof $10,138,000 was accumulated by charges to operating expenses. The account "Depreciation and Contingencies" stood on January 1, 1917, at $1,633,000.00. These two funds totaled approximately $11,741,000.00 on this date.

About this time the company apparently concluded to abolish "depreciation" and accordingly transferred this amount to a new fund called "Contingencies." They cannot by this mere change of terms or titles alter the character of the account, its purpose, and the manner in which these huge sums were accumulated. This money was accumulated, to put it simply and fairly, to cover depreciation. No other intent or purpose appears and, in fact, no other intent was present in the minds of the directors who created the two original funds in 1909 as evidenced by the resolutions which we have heretofore quoted. From August 9th, 1917 to December 31st, 1923, the date to which testimony in this case was presented, the new account "Contingencies" accumulated about $848,000.00. This brings the total up to the present sum of $12,589,000.00 in the so-called "Contingency Account."

We print herewith a tabulation from the books of the company showing here the two funds were built up and transferred to the alleged "Contingency" account.

## THE BROOKLYN UNION GAS COMPANY

*Reserves*

### Accrued Amortization of Capital

| | 1913 | 1914 | 1915 | 1916 | 1917 | 1918 | 1919 | 1920 | 1921 | 1922 |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance at beginning of year | $4,899,037 | $6,196,502 | $7,595,294 | $8,945,686 | $262,967 | $348,834 | $520,623 | $677,675 | $847,516 | $942,811 |
| Credits during the year | a1,351,527 | a1,435,570 | a1,387,512 | a1,503,148 | b195,853 | b208,909 | b205,884 | b236,976 | b208,132 | b207,898 |
| Charges during the year | d54,063 | d36,777 | e37,120 | e47,821 | g109,985 | g37,120 | g48,831 | g67,136 | g112,837 | g219,540 |
| Balance end of year | 6,196,502 | 7,595,294 | 8,945,686 | 10,401,014 | 348,834 | 520,623 | 677,675 | 847,516 | 942,811 | 931,258 |

### Depreciation and Contingencies

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance at beginning of year | 1,788,310 | 1,742,467 | 1,682,094 | 1,649,292 | | | | | | |
| Charges during the year | h45,842 | h60,373 | e32,802 | e46,059 | | | | | | |
| Balance end of year | 1,742,467 | 1,682,094 | 1,649,292 | 1,603,232 | | | | | | |

### Contingencies

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Balance at beginning of year | | | | | 11,741,279 | 12,589,976 | 11,589,976 | 12,589,976 | 12,589,976 | 12,589,976 |
| Credits during the year | | | | | c848,696 | | | | | |
| Charges during the year | | | | | | | | | | |
| Balance end of year | | | | | 12,589,976 | 12,589,976 | 12,589,976 | 12,589,976 | 12,589,976 | 12,589,976 |

a—On basis of 15c. per M. C. F. sold less actual cost of repairs.
b—On basis of 1.5c. per M. C. F. Sold.
c—On basis of 6.5c. per M. C. F. Sold.
d—Charges for retirements.
e—Proportion of depreciation on equipment retired.
g—Cost of property retired less salvage.
h—Charges for fixed capital retired during year.

In addition, it appears that when the plaintiff company transferred the amount of $10,138,000.00 from its account "Accrued Amortization of Capital" to the account "Contingencies," that this was done without the sanction or permission of the Public Service Commission and it, furthermore, appears that the Commission protested to the complainant because of the transfer to the "Contingency" account (Master's Findings 67, 68, Record, pp. 110, 111).

This sum of $12,589,000.00 does not exist today in the form of cash. It is quite impossible to point out exactly where each dollar of this fund has gone; the the Public Service Commission of this State in one of its recent opinions in reference to a similar fund said, "We cannot tag each dollar of this fund." There is no doubt, however, that all of this money was reinvested by the company in its own plant and structures for additions, betterments, etc. In the prior case of Brooklyn Union Gas Co. v. Nixon, Judge Mayer in his opinion, 2 Fed., 2nd, pages 118, 119, said:

> "The *Contingency* fund. * * * The so-called fund, however, does not exist *as cash. It has gone into the property in one form or another.*"

This fund is similar to the so-called "Contingency Fund" in the Consolidated case and the law and argument presented in our brief on this point applies in this case. To avoid repetition we refer to pages 73-77, of our brief in that case and especially to the cases of

> In Re N. Y. Telephone Co. v. N. Y. P. S. C., No. 1789;
> Louisianna v. Cumberland, 212 U. S., 414:
> Re Brooklyn Borough Gas Co., P. U. R., 1918-F, 335.

We urge under all the facts and law as set forth in this point and under a similar point in our Consolidated brief that the fund of $12,589,000 accumulated for depreciation purposes shall be considered in the alternative as,

(a) The company's own estimate of the depreciation in this property and therefore to be deducted as such from the Courts finding of Present Value (the Court allowed for no deprecation), or

(b) Since the company reinvested this fund in plant and property it should be excluded from the rate base found by the Court and Master. Being beyond doubt assets of the company involving no outlay by investors but in reality coming from the consumers it must be deducted from the valuation of the company property (valuations of course included *all* the company properties whether purchased by investors monies or this fund). As our N. Y. Commission forcefully argued in the recent telephone case, if this fund had remained in cash in banks, the consumers certainly would not be called upon to pay a rate predicated upon its inclusion in a rate base. Should the mere fact of having reinvested the fund in property for the benefit of the company, operate to increase the rates of the consumers, from whom the money was taken?

## POINT III.

**A fair allowance for working capital for the appellee company should not have exceeded $3 000,000 and the Court below erred in allowing $5 000,000.**

Working capital has been defined as the amount of cash and supplies or other available assets readily convertible into cash reasonably necessary

to be kept on hand for the purpose of meeting current obligations as they arise.

*Maryland P. S. Commission, re Chesapeake Tel. Co.*, P. U. R. C., 925.

The Master has allowed $5,000,000 for this item, saying:

> "The average working capital of plaintiff during the year 1923 was actually $10,184,975.63. A fair and reasonable amount of working capital for plaintiff exclusive of such working capital as is required to manufacture and supply gas to the so-called subsidiary companies is the sum of $5,000,000" (Finding 107, p. 117).

In this case as in the Consolidated case the evidence presented was simply an addition of certain figures without the necessary analysis to show how much was needed for working capital (see Exhibit 259, p. 1952).

Mr. Payne, appellee's auditor put in a table which briefly was as follows:

| | |
|---|---|
| Materials and Supplies | $ 2,797,692.43 |
| Cash | 4,378,096.95 |
| Accounts Receivable Excluding Associated Companies | 1,169,820.91 |
| Prepayments | 240,801.55 |
| Special Deposits | 101,020.63 |
| Suspense | 1,497,543.14 |
| Total | $10,184,975.63 |

He very briefly explains it (pp. 777, 778). He does not say what the item "suspense" $1,497,543.14 represents. Neither does he state how much of the cash is needed for operations, how much for con-

struction and how much for the subsidiary companies. The cash item is of course enormously high. In the Consolidated case only $2,000,000 is claimed. As to materials and supplies he makes no segregation deducting materials and supplies used for construction and for affiliated companies. No reference appears as to the average bills payable.

Under these circumstances it was entirely erroneous for the Master to make the finding above noted. What is given are a lot of unrelated figures unexplained and unanalyzed. To call it "the average working capital" of appellee is simply to accept blindly the caption on the exhibit.

Miller the only other witness on this subject with the same facility as in the Consolidated case, testified to the same simple multiplication, i. e., that appellee's working capital should be 40 cents times its gas made and sold to its own consumers plus 20 cents times its gas sold to subsidiaries.

He "could not tell the average amount of coal on hand" (p. 1074) nor had he "formed an opinion as to the average amount of coal, coal in tons, it would be necessary for the company to carry" (p. 1074). He thought the company should have "thirty days supply of oil" but did not know whether it had that much storage capacity (p. 1674).

He knew nothing of the "terms of credit" on which appellee bought its materials and said that "the terms of credit * * * would not make any difference * * * as to the amount of working capital the company might need" (p. 1075). Neither did he know anything about "Weekly or monthly payrolls" (p. 1076).

His testimony in brief, does not analyze at all and is not of any particular value.

In the Court below counsel for the Public Service Commission made a very careful study of the

working capital requirements of appellee based on an analysis of exhibits in evidence showing the stock of materials carried by the appellee and its requirements for operating expenses.

Counsel first quoted the following very clear analysis by Commissioner Semple in re The Long Island Lighting Company (P. S. C. Report, Vol. 1, p. 408 at pp. 420-421):

> "The company has a right to have included in the value of the property, which is given to the public service, a sum which shall be adequate for working capital. This represents moneys advanced by the company other than fixed capital for which it is to be reimbursed when its revenues are collected. The necessary amount depends upon the reserve in stock and the amount expended for wages, salaries and materials used in producing and distributing gas up to the time the moneys are recovered from the consumers. The latter amount depends again upon the time intervening between the date when payment is made by the company for materials, wages, etc., and the date when consumers pay to the company their bills for gas used. In these accounts receivable are included and paid by the customer not only a sum sufficient to reimburse the company for what it has spent in operating expenses for payrolls and materials and supplies necessary in the manufacture of gas for which the consumer pays; but the sum also includes in it what the consumer pays in addition, representing the profit to the company on its business or the return made

by the consumer upon the investment which the company has put into its business.

"In order to establish the facts, it is pertinent to know the cost of materials and supplies, like coal oil and other gas-making materials and appliances used and held for use, discounts obtained on the purchase of materials or supplies, the amount of coal and oil received and when the coal and oil received is paid for, the amount paid in wages and salaries, and the pay-days or intervals between the payments of wages and salaries, the practice of the company as to its meter readings, delivery of bills weekly or monthly, the dates sent out and the amount of time taken by consumers for the payment of bills, the practice of the company in allowing discounts for prompt payment or imposing penalties for delay and the question whether or not the company uses apparatus or contrivances, like prepayment meters, which may be found efficient in obtaining payment for gas from users of small amounts from whom payment might be difficult.

"What ought to be provided by working capital for operating purposes is what needs to be paid out in advance of the collection of the accounts, like payrolls, materials and supplies on short credit. It does not apply to taxes, which are payable at some one or two stated periods in the year and for which advance provision can readily be made out of income and its does not include such matters charged in operating expenses as were really not paid out in cash such as uncollectible bills and the amortization reserve for depreciation."

In order to determine what the history of the company has been in this regard and what its practice has been in maintaining a supply of stores and materials, an examination of its 'Materials and Supplies' account must be made. The total amount of the monthly balances in this account was $28,575,709.31 for 1922, and $33,572,309.23 for 1923 (Pltf.'s Ex. 259, p. 1952, fol. 2867).

A summary of the amounts carried upon plaintiff's books for coal and coke used in the generators and under the boilers, is as follows:

| | |
|---|---|
| 1922 | |
| Boiler Coal Stations ..... | $ 181,979.96 |
| Gasogene Coal, Works ..... | 12,546,450.10 |
| Boiler Coal, Works ..... | 391,856.62 |
| Coke, Works ..... | 87,089.85 |
| Total ..... | $13,207,376.53 |
| 1923 | |
| Boiler Coal, Stations ..... | $ 126,891.19 |
| Gasogene Coal, Works ..... | 13,304,003.24 |
| Boiler Coal, Works ..... | 149,508.51 |
| Coke, Works ..... | 81,439.70 |
| Total ..... | $13,661,842.64 |

There must be deducted from the "Materials and Supplies" account these figures for boiler and generator coal and coke in order to substitute for them a computation based upon the company's operating statistics for the year 1923 as shown in Plaintiff's Exhibit No. 258. This substitution of the proportionate amounts of coal and coke used by the company results in a more reasonable allowance for these commodities, since the figures substituted show an actual two months' usage as against an item

for coal and coke in 'Materials and Supplies' which include the very large reserves kept on hand by the plaintiff. With these items eliminated from the totals for materials and supplies, the result is as follows:

| | | |
|---|---|---|
| 1922 | | |
| Total M. & S. 12 months | $28,575,709.31 | |
| Deduct coal and coke | 13,207,376.53 | |
| Net M. & S. excl. of coal and coke | | $15,368,332.78 |
| 1923 | | |
| Total M. & S. 12 months | $33,572,309.23 | |
| Deduct coal and coke | 13,661,842.64 | |
| Net M. & S. excl. of coal and coke | | $19,910,466.59 |
| Total M. & S. for 2 years (excl. coal and coke) | | $35,278,799.37 |

This sum shows the total of the monthly figures for materials and supplies for 1922 and 1923, exclusive of the amounts carried in that account for coal and coke. In order to arrive at the net amount of materials and supplies on hand at the end of an average month over this two-year period, excluding as we have in this computation for the moment, coal and coke, this sum must be averaged for this period, and, as a result, a figure of $1,469,946.97 is obtained which represents the average amount of materials and supplies carried on hand by plaintiff over a period of 24 months, exclusive of an amount for coal and coke.

On page 1646, Exhibit No. 258, there appear the following quantities and prices for coal and coke:

| | Quantity (tons) | Average Price | Amount |
|---|---|---|---|
| Generator fuel-coal | 212,413.13 | $11.0035 | $2,337,287.09 |
| Generator fuel-coke | 110,330.26 | 10.2540 | 1,131,324.41 |
| Boiler fuel-coal | 44,841.15 | 8.9949 | 403,341.22 |
| Boiler fuel-coke | 11,491.52 | 10.3174 | 118,562.38 |
| Total coal | | | $2,740,628.31 |
| Total coke | | | 1,249,886.79 |
| Total | | | $3,990,515.10 |

This last figure represents the total amount expended by the company during the year 1923 for coal and coke actually used. In our computation we have used as the amount necessary to be included in working capital a figure which would cover a two months' supply of coal. This is an entirely reasonable provision and was so considered by plaintiff's witness Miller upon his cross examination with regard to the proper amount of coal and coke which should necessarily be carried on hand by the plaintiff (p. 1074). Taking one-sixth, therefore, of the figure given immediately above, which would cover a two months' period, the amount to be added to our total figure for materials and supplies, exclusive of coal, is $665,085.85.

Combining this figure for coal and coke with the amount shown hereinabove for the amount of materials and supplies carried at the end of an average month, to wit: $1,469,949.97, there results as the total for materials and supplies, including coal and coke, for an average month's balance over a period of two years, the sum of $2,135,035.82.

In addition, there should necessarily be included in the estimate for working capital an amount which will cover the company for those normal operating expenditures referred to in the opinion quoted above, which it is compelled to meet as part of its daily and weekly routine. In the determination of an amount to be allowed for the company's operating expenses, a similar difficulty is presented with regard to the quantum of this allowance. The proper allowance should be based upon the actual experience of the company as shown in its books and records. After an analysis and examination

of these sources as the only trustworthy guide, our estimate of the amount for operating expenses, which should be included in the figure for working capital, has been prepared.

It clearly appears from an analysis of Plaintiff's Exhibit No. 258 (p. 1944) showing the operations of the plaintiff in the conduct of its business, and from Plaintiff's Exhibit No. 259 (p. 1952), showing the tabulation of averages for Accounts Receivable over a period of two years, for the year 1922 the average outstanding monthly balance under Accounts Receivable represents 64.11% of the average sales computed from Plaintiff's Exhibit No. 258; and that for the year 1923 the average computed on the same basis is 78.64%. These two percentages averaged 71.38% for the two years. This result shows that at the end of an average month there would be approximately 30% less of accounts receivable than actual sales by the company, and that if an entire month's operating expenses were to be allowed the company as part of its working capital, the plaintiff would have an ample allowance for current expenses, since a very material percentage of its accounts receivable had come in during the current month. This is a very fair basis on which to compute an amount for operating expenses, which, together with the allowance heretofore arrived at for materials and supplies, would constitute the sum estimated for working capital.

In determining a figure for operating expenses for an average month, the basis used for our computations is the actual experience of the company for the year 1923 as appears in Plaintiff's Exhibit No. 258, with certain deductions. During 1923 the company's

total operating expenses were $14,375,310.98 (Pltf.'s Ex. 258, Sheet 3). There must be deducted from this gross total the following items:

| | |
|---|---|
| GENERAL AMORTIZATION—This item does not represent a cash outlay but is merely a bookkeeping entry in no way affecting the amount to be estimated for working capital | $229,505.61 |
| UNCOLLECTIBLE BILLS—This is not properly to be included since it is not the subject of a cash or current transaction and should not be included in a computation for working capital, in addition, since it is not representative of any expenditure on the part of the plaintiff | $ 54,849.00 |
| GROSS EARNINGS TAX—That portion of the tax is deducted which has been apportioned (Defendants' Exhibit No. 157) to the returns from revenue derived chiefly from sources other than the manufacture and sale of gas | $ 51,773.00 |
| TRANSPORTATION EXPENSE — This amount is the difference between the amount shown in complainant's operating expenses for the year and the amount indicated in Defendants' Exhibit 158, which is the result of an apportionment of the 1923 transportation expense based on the allocation by plaintiff of its transportation expense during the first six months of 1924 | $ 79,656.24 |
| PROMOTION EXPENSE—This amount is the result of a calculation apportioning to the subsidiaries the proper amount of expenses under this classification as shown on Defendants' Exhibit 171 | $ 62,963.26 |
| Total | $478,747.11 |

Deducting this total from the operating expenses for the year 1923 and dividing the result by twelve, in order to obtain a proper monthly average for the year, there results the sum of $1,158,046.99. For the purpose of de-

termining a fair allowance for working capital appellee has been given every possible benefit. There have been omitted from the total of deductions other items which might well have been included.

The total amounts for materials and supplies and for operating expenses which, together make up the estimate of working capital are as follows:

| | |
|---|---|
| Materials and Supplies ... | $2,135,035.82 |
| Operating Expenses ..... | 1,158,046.99 |
| | $3,293,082.81 |

From this amount there should be deducted the working capital devoted to the manufacture of gas for subsidiary companies. The gas made for these companies. (4,942,894 M cubic feet) is 22½% of the total manufactured (21,984,891 M cubic feet). Deducting 22½% from the total requirement for materials and supplies $2,135,035 leaves $1,650,000 applicable to gas made for the consumers of appellee. A similar deduction from the production expenses leaves $1,000,000 as the requirement for operating expenses applicable to the sale of appellee. These two amounts total $2,650,000 which represents the reasonable requirement for working capital for this company. An allowance of $3,000,000 would be more than fair.

This is particularly liberal in view of the fact that the company has on hand December 31, 1923, the sum of $1,872,830 consumers deposits (p. 817). It is true that the company accumulates interest on these deposits at 6% compounded semi-annually. That it pays out at any such rate, however, does not appear. On the contrary it appears that interest is paid out only when the deposit is called for and there are frequent cases in which it is never called for (p. 818). This money, much of which

will never be used "is treated like any other cash received" and "becomes part of the general fund" (p. 819).

## POINT IV.

### There is no justification for an additional allowance for going value in this case.

The Master in this case has correctly refused to add anything to the fair value of the property for so-called going value. But although his ultimate conclusion is correct he added to his report at the last moment a finding on this subject which has not a shred of credible evidence to support it.

In Finding 110 (p. 119), he says:

> "Going concern value exists in the instant case. I fix that value at $6,000,000. I have not included this item in reproduction cost, nor in adopting a rate base, for the reason that even without such an allowance the statute is clearly confiscatory."

It seems to follow that if the statute had not been confiscatory without going value he would have made it confiscatory by putting it in.

Of course the question in such a case as this is just the opposite to that stated by the Master. The province of the Court is not to find how many items such as going value need be thrown in to make the statute unconstitutional but whether the statute can be held constitutional if every doubtful element is left out of consideration.

Nothing in the whole case so clearly shows the Master's fundamental lack of the proper viewpoint for deciding this case or his unfairness because of this improper viewpoint.

The Master with lawyerlike thoroughness demolishes completely the flimsy structure attempted to be reared by Colonel Miller of the vivid imagination and which was the entire basis for plaintiff's claim as to going value. He says (p. 82):

> "The method of measuring going concern value adopted by Colonel Miller, however, seems somewhat novel and without precedent in any of the adjudications to which my attention has been directed. The hypothesis is so difficult to conceive and so contrary to general experience that the imagination falters. If one were to indulge in such an imaginative picture, it would seem more readily conceivable that the demand by the community would greatly overtax the production capacity of the company, rather than to assume the necessity for an outlay of $35 to educate each consumer and convince him of the desirability of utilizing plaintiff's output. The more I have considered this evidence of Colonel Miller, the more reluctant I have become to adopt this estimate for the purpose of evolving some fixed allowance of going concern value."

He also stated (p. 81) that:

> "Plaintiff rests its contention upon the testimony of Colonel Miller"

whose figure was $16,000,000 on the basis of $35 per active meter.

He finally concludes however:

> "I am of the opinion that, even disregarding the testimony of Colonel Miller, the authorities would justify an allowance upon the balance of the evidence in the case in the quantum to which I have alluded, approxi-

> mately twelve per cent. of the property value, or about $6,000,000" (p. 83).

Just what the other evidence is he does not state. A close examination of record fails to reveal any. It is plain therefore that the figure comes full grown out of the Master's imagination. It might as well be $60,000,000 as $6,000,000. If such imaginary figures are to be summoned from the inner consciousness whenever deemed necessary to declare a statute unconstitutional the sovereign State of New York has indeed a dreary prospect ahead of it in any endeavor to limit the rates of utility companies.

As a matter of fact there is no basis for an allowance for going concern value in this case. The companies which plaintiff took over thirty years ago had built up their very profitable business out of earnings entirely and had paid handsome dividends besides. Plaintiff has never had a single item of capital expense for attaching its business not reflected in its capital accounts.

The "authorities" to which the Master refers are apparently those cited in the brief before him filed by this appellee. For he says:

> "Counsel for plaintiff has very industriously collected allowances for going value in court cases and in commission cases, showing what percentage upon the property value was allowed in each case" (p. 82).

It is unfortunate to have to spoil this picture of the industry of appellee's counsel but the truth must be told. The table is not the result of any industry but was borrowed bodily from the brief of Consolidated Gas Company in its case before its Master. This table is printed in appellant's brief in Ottinger v. Consolidated Gas Company (p. 101,

102) and is analysed there (pp. 103-108). No more need be said about it here.

The fact that two Masters have been misled by such a table of cases is sufficient evidence of the ephemeral character of "going value" and the impossibility of any adequate proof as to its amount. As the Court below made no specific allowance for this item no more need be said on this point.

*The appellant presented its argument in full upon the question of "going value" in the Consolidated brief and we respectfully refer the Court to pages* 87-109 *thereof.*

## POINT V.

**The Court below should have found that the reasonable and necessary cost of making and distributing gas of the quality actually made should not have exceeded 78.83 cents per thousand cubic feet sold.**

The statute here under attack came into effect on June 3, 1923; consequently, the first calendar year under its provisions was the year 1924. During the first five months of the year 1923 the company enjoyed a rate acceptable to it of $1.15 per thousand; also the prices of material were considerably higher in 1923 than they were in 1924, as is generally recognized. Gas oil, for instance, the principal ingredient in making gas, was bought by the plaintiff company in 1923 for 5.67 cents per gallons (Master's Finding No. 144, p. 129). In 1924 the price per gallon was only 4.7 cents. The company refrained from putting in evidence as to costs in 1924. The reason is obvious. Prices were going down. And although the bearings did not close until September, 1924, not only are there no

figures in the record showing the cost of making gas from June 1, 1923 to June 1, 1924, but the figures given for 1923 are not segregated so that the Court could judge what was the cost of making gas under the statute from June 1, 1923 to December 31, 1923. All we have is the company's figures for the calendar year 1923 as a whole.

## Cost of Manufacture.

The Court below has confirmed the Master who took, without material variation, the book figures of the plaintiff company on the cost of making gas, and finds that such cost for the year 1923 to be 49.03 cents per thousand (Finding No. 177, p. 145). In so doing the Master has, it is earnestly contended, proceeded on an improper basis. In the former Consolidated Gas Company case this subject was carefully considered by two very able minds—those of Special Master Abraham S. Gilbert and of District Judge (now Circuit Judge) Learned Hand. Both came to the conclusion that in a case of this kind the cost of making gas should be judged not on the actual figures of the company, including all of its plants, good, bad and indifferent, but on what it would necessarily and reasonably cost to make gas at the most efficient plant.

Special Master Gilbert, in his report (Rec., Newton v. Consolidated Gas Co., pp. 52a, 53a), says:

> "* * * Having in mind that the plaintiff must prove its case beyond any reasonable doubt, I reached the conclusion that the safest basis upon which to work was the actual result of operations in the Astoria plant for eight months ending August 31, 1919, that plant being a most efficient manufacturing plant with modern labor-saving devices.
>
> * * * * * * * *

> To my mind it is impossible for any one seriously to dispute that figure. I have therefore found as a fact that the cost of making gas *at this time* (May 5, 1920), is not less than 46.09 cents plus 1¢ storage expense, making 47.09 cents for gas made. That was the average cost for eight months in 1919. Since that time the price of oil has gone up. The price of coal has gone up. The price of labor is constantly going up. Any figure beyond the figure shown by actual operation for the first eight months of 1919 would be speculative, and I have avoided basing any conclusions on fragmentary or incomplete date of operations." (Italics and date in parenthesis ours.)

Judge Hand was not content to limit the standard to the Astoria plant as a whole but took the two best units of that large plant.

> *Consolidated Gas Co.* v. *Newton, et al.*, 267 Fed. Rep., 231, 250.

Neither the Master nor the Judge assumed that in taking the Astoria plant as a standard, he was passing judgment on whether the entire output of the company should be made at the Astoria plant, but merely set up the standard and left it for the company to decide whether it would make gas at its most efficient plant, bring its other plants up to the same standard of efficiency or indulge itself in the luxury of making some of its gas in less efficient plants.

If the principle were applied to the plaintiff company there is no question that the plant to be taken as a standard would be the Metropolitan plant. The comparative book figures of cost of manufacture at the various plants of the plaintiff company for the year 1923 were as follows (Finding 166, p. 134):

| | 1923 |
|---|---|
| Metropolitan ..... | 44.59¢ |
| Fulton ..... | 46.18 |
| Williamsburg ..... | 47.09 |
| Nassau ..... | 47.83 |
| Citizens ..... | 53.01 |
| Equity ..... | 58.43 |

The testimony of appellee's chief engineer was that the reason for the Metropolitan's greater efficiency was that since 1911 it has had machines of a uniform size and style, has been more "compact" and has been developed from a "preconceived plan" (Master's Finding No. 168, p. 134).

It is a modern plant to the extent that it was up to date fifteen years ago. Probably the Citizens Works will be a good plant when it is reconstructed. It is so expected (p. 720). But now the Williamsburg and the Fulton plants are far behind the times. The Nassau and Citizens had abnormal experiences because of reconstruction and the Equity is hopelessly out of date and inefficient.

The same situation has existed for years (Bush, p. 717), and it is quite evident that the Metropolitan works is the only safe standard. However, the evidence seems to show that three of the other plants were reasonably efficient during the years 1922 and 1923; they are the Fulton, the Williamsburg and the Nassau plants. Certainly, the benefit of the doubt will be given to the plaintiff if the average of these four plants is taken as the standard for making gas. The weighted average of the cost of making gas at these four plants for 1923 is 46.40 cents. This is especially liberal to the company when it is considered that the Nassaus plant was not working at top efficiency in 1923. This is the only plant which had higher costs in 1923

than 1922 (p. 708). The evidence shows that Bartlett Hayward, the construction engineers were using a large amount of steam from this plant during this year which accounts for the high cost (p. 705). Also because of construction work the output fell and costs correspondingly increased (p. 708).

The Equity plant is an anomoly in this generation. Its cost of production, as appears above, was practically 14 cents over that of the Metropolitan plant and this is a measure of its inefficiency. The testimony shows that no improvements have been made at this plant for several years (p. 379). Coal is entirely handled by hand (p. 379); even the coal buggies are pushed around the plant by hand (p. 379). Gas-making labor in 1922 was 12.15 cents per M as against 5.41 cents at the Metropolitan. In 1923 the gas-making labor was 11.85 cents as compared with 4.76 cents at the Metropolitan plant (p. 709). The tar recovery was less at the Equity than it was at any other plant (p. 681). The Equity used twice as much boiler fuel as did the Metropolitan (companys' report for 1923 to Public Service Commission in evidence). In fact, there is scarcely any figure in regard to this plant, which does not speak in loud tones of the inefficiency of this small old plant. The expense of manufacture at this plant must be disregarded in arriving at the necessary and reasonable cost of production. If companies are to be allowed to include such inefficient manufacturing plants in their operating statements, in a case of this kind, it will put a premium on such inefficiency and the solemn enactments of the Legislature can be readily overturned by failing to take reasonable steps to pursue efficient methods.

As to this plant the Court below says:

"The plant where the cost of operation was the highest was the Equity, which serves a remote section of the territory in which plaintiff furnishes gas, and I find nothing in the evidence which warrants a finding that this plant could be dispensed with or that the cost of operation of this plant should be standardized on the basis of the cost of operation of a large plant which can serve the territory adjacent to it and which is favorably located" (p. 217).

In Pacific Gas & Electric Co. v. San Francisco, 265 U. S., 537, this Court stated that a company should not suffer because it made improvements that caused the cost of operation to decrease. The converse is as true. The consumers should not suffer because the company does not choose to make improvements which would reduce the cost of making gas to a reasonable figure. If the stockholders of the Brooklyn Union Gas Company choose to make gas by inefficient methods at one of its plants should not the stockholders rather than the consumers bear the attendant loss?

The reasons for disregarding the cost of production at the Citizens plant are even more potent. The Master finds (No. 169, p. 134) that "During the year 1923 the operating conditions at the Citizens Works were not the best, for the laboring men were considerably hampered by construction work going on there in that year." The testimony shows that during the years 1922 and 1923 new installations were being erected at the Citizens plants; the final result was that its capacity was tripled over that which it had in 1920, going from a capacity of 8,500,000 cubic feet per day to 27,200,000 (p. 377). The new installations are of the latest model and will result in economies at this plant, but while they are being

installed the operations are not normal. For instance, there is testimony that the boiler fuel at the Citizens Works during 1923 was 17.61 pounds per M cubic feet as against only 10.52 pounds at the Metropolitan Works (p. 704). This was explained by witness Bush, superintendent of manufacture, as follows:

> "In the case of the Citizens Works as I have already explained, there was a great deal of construction work going on throughout the year 1923. The Bartlett-Hayward Company or the contractors used a very considerable—in fact a large amount of steam for their riveting hammers, both in the works and for holder construction, and the steam was furnished by the Citizens Works. That accounts in my opinion for the discrepancy" (pp. 704, 705).

Again, the repairs at the Citizens Works for 1923 amounted to 7.47 cents per thousand as compared with the figure of the Metropolitan of 1.85 cents. This difference was accounted for by Witness Bush, as "due to the amount of work that was done there during the year 1923" (p. 711). Moreover, there was a cave-in at the Citizens Works in 1923 and this resulted in an increase of repairs (p. 713). Witness Bush summed up the situation as follows:

> "We will take the Citizens Works, for example, and this applies to all their results, particularly during the last year, that is 1923, and also in 1922. But we will take the last year. They had the condition there which made it most difficult to get reasonably good results. In the first place they were operating at the same time when there was a very great deal of construction work going on, very considerable changes being made, and

that interferes very greatly with the operation of gas sets when you have workmen carrying things out all around and upsetting the conditions, and the men around the machines are afraid to operate, they have something on their hands. That is the thing that affects operation. Also another thing I think that shows up at the Citizens Works is this: Due to the construction work going on we were not able to operate the plant at as large a capacity as we would like to have done and as we might have done had it not been for the construction work. If they operate a plant at a higher percentage of its capacity we get better operating costs and everything else (pp. 677-678).

The Master recognized the force of this contention (Finding 171, p. 135), where he states:

"During the year 1924 the cost of production at the Citizens Works will be lessened by the operation of the recent installation of improved plant equipment."

It certainly would be most unfair to include the temporarily excessive costs at this plant in arriving at a figure for the cost of manufacturing gas. The Court below says as to this:

"In some instances the costs of manufacture were higher because certain repairs were in progress during the period under consideration, but the consumer cannot get the benefit of lower cost and more efficient service unless the plants were kept in repair and the attainment of greater efficiency is the motive for making the repairs, which will reduce the cost of operation.

"The making of repairs must be going on

each year in one plant or another if efficiency is to be preserved, and the plaintiff should not be penalized for keeping its plant efficient" (p. 217).

The Court, it must be said with deference, entirely misconceives the evidence. The testimony was not that "repairs" were going on which would "reduce the cost of operation."

As the testimony above quoted shows, what was going on was new construction which resulted in tripling the capacity of the plant as it existed in 1920. It was a purely abnormal condition as the witnesses all testified and as the Master found. Nor is the argument sound that similar work is always being done at one plant or another. To triple the capacity of a plant is an extraordinary operation. Not only has it never been done at the other plants but it could not be done in the space occupied. There is not one word of testimony that it is contemplated at any other plant. The suggestion that the Court adopted was found only in the briefs of appellee's counsel.

Such abnormalities as existed during 1922 and 1923 at this plant are not the material on which rates shall be declared unconstitutional. The Court recognized this in excluding rate case expense and the expense of adjusting appliances (p. 218). He disallowed these expenses "because they are abnormal and should not be regarded as a part of the cost of manufacture for this purpose."

Exactly the same reasoning applies to the abnormal expenses at the Citizens Works and it has frequently been applied in other cases.

**See**

Consolidated case v. Newton, supra (p. 255).

The Court below seriously erred, therefore, in including the costs of operation of the inefficient Equity plant as well as the abnormal costs at the Citizens plant.

As the base figure therefore it seems entirely reasonable to accept the weighted average cost of operation at the four fairly efficient plants of the plaintiff company. This figure, as we have said above, is 46.40 cents per M cubic feet for the year 1923. However, as has been indicated above, the cost of oil for the year 1924 was lower than in the year 1923 and to get a figure for the cost of making gas during the first calendar year after the statute went into effect, it is necessary to reduce the above figure by 3.07 cents. The difference in cost per gallon of gas oil is .87 cents and the plaintiff company used 3.52 gallons of oil per M cubic feet. Consequently, for the year 1924 the base figure above indicated must be reduced by 3.06 cents which gives a revised figure of 44.61 per M cubic feet after adding thereto the maintenance of outside holder stations of 1.27 cents (P. S. C. Report in Evidence).

In the Court below appellant urged a reduction in reasonable operating expenses because of the very apparent abnormalities in the repair costs at plants and holder stations during the years 1922 and 1923.

The Master found these costs for the years 1918 to 1923 inclusive to have been as follows (Finding No. 164, pp. 133, 134):

| | |
|---|---|
| 1918 ..... | $309,400.92 |
| 1919 ..... | 375,314.50 |
| 1920 ..... | 656,207.63 |
| 1921 ..... | 737,624.14 |
| 1922 ..... | 623,215.16 |
| 1923 ..... | 850,398.00 |

The cost increased from 1918 to 1923 from 2.02 cents per M made to 3.87 cents per M made. As has been pointed out above the witnesses admitted that the abnormal amount of construction work going on increased these costs. No doubt they are abnormal and like other abnormalities should have been eliminated from the Court's finding as to production costs.

As to this the Court says (p. 217):

> "To calculate repairs on the basis of the average for five years shows but a negligible difference from a calculation as made by the plaintiff, but it might properly entail a consideration of varying costs of material and labor without producing a result which would be as nearly accurate as that which was made by the plaintiff and approved by the Master, as the evidence shows that we may reasonably assume that present prices will continue for some time."

As a matter of fact no "calculation" whatever was made by appellee. All that was done was to put in the book figures after which the evidence shows that the book figures reflected abnormal conditions. Some deduction for this very apparent abnormality should have been made.

Nor does cost of materials account for the increase. Prices were lower in 1923 than in 1919 (Ex. 280, p. 1952, fol. 2872), yet the cost of repairs increased over 100% in 1923 as compared with 1919 considered either on the basis of dollars or on the basis of cost per M of gas made.

In the Court below we asked only for a deduction of .58 cents on this account, basing the calculation on an average of the six years. Probably a much larger figure should be deducted. Certainly

the Court below was in error in making no deduction whatever.

If this .58 cents is deducted as it should be the final figure for cost of manufacture becomes 44.03 cents per M cubic fee[illegible] made.

## Gas Unaccounted For.

There is always a difference in the case of every gas company between the amount of gas manufactured and the amount which is paid for by the consumers. The difference, as the name implies, is unaccounted for, but is supposed to be due to condensation, leakage, slow meters, and other causes. The Special Master in this case has allowed the unaccounted for at a figure of 10.57% for 1923. It is earnestly contended that the plaintiff did not sustain the heavy burden of proof as to this item. It was obviously impossible for the defendants to analyze the past operations of this great company, and find out how this large unaccounted for came about. The only method by which this reasonably can be judged is by comparing it with the unaccounted for of the only other company in its vicinity, comparable with it—the Consolidated Gas Company. This company which operates in New York City has, it is true, a somewhat denser population than is served by the Brooklyn Union Gas Company, but still the situation of the two companies is comparable. The Consolidated Gas Company, in its former litigation, in the years 1919 and 1920, claimed unaccounted for of 7%. Like the Brooklyn Union the Consolidated has numerous subsidiaries which sell gas. It is impossible to tell the exact unaccounted for for each company. As in the case of the Brooklyn Union the only fact that can be ascertained is the difference between the amount made by the System and the

amount sold by the System. Also as in the case of the Brooklyn Union Gas Company so in the case of the Consolidated Gas Company, subsidiary companies serve a much less densely populated territory than does the parent company. As to the unaccounted for in the Consolidated, Judge Hand said at page 244, in Consolidated Gas Co. v. Newton, et al. supra, pp. 244, 245) :

> "Into all the calculations there must come the loss of gas occasioned by condensation, leakage, and perhaps other causes. It becomes necessary to know by how much the plaintiff's production must be taken to be larger than the sales passing through the customers' meters. While it is quite possible to tell this with accuracy for the whole system of which the plaintiff is a part, it is impossible to do so for the plaintiff separately, owing to the interchangeable connections of the mains. The loss of the system as a whole has been reported yearly to the Public Service Commission, and represents the difference between the gas made and the sum of gas recorded by customers' and company's consuming meters. The years 1917 and 1918 were abnormally cold and showed an unusual loss of this kind. Obviously they are not a fair specimen of the normal loss occurring from these causes. The average for the whole system over the period of 13 years during which the statistics were given to the authorities was 5.31 per cent., and, unless there are some disturbing factors, this is a valid starting point, which the company must accept. The only disturbing features suggested here are the poorer quality of coal and oil, and I take against the plaintiff any doubt which those factors may raise. I accept the average of 5.31 as a proper allowance for the system as a whole, at least in a rate case.

"The allowance to the company is certainly less than this figure, but how much must remain in doubt. The estimated average as reported by the plaintiff to the Public Service Commission for the years 1906-1918, inclusive was 4.09, and there is a strong presumption that this is correct. Nearly the same result may be reached by another method. It appears to be accepted that 3 per cent., is the proper allowance for all waste but main leakage, which varies inversely with the density of the customers per main mile. Now, taken grossly, the company has about double the density per main mile of the other companies. We may then apportion the sum of 2.31 per cent. for main leakage correctly by dividing the main mileage of the company in half and using the resulting sum for the total mileage. Assuming the total output to be 33 billions, of which the company will furnish 20 billions, the systems' loss from main leakage is 762.3 millions, of which the loss attributable to the company is 28 per cent. or over 223 millions. This is about 1.12 per cent., which, with 3 per cent., equals 4.12 per cent. of the gas made, which is surprisingly close to the average reported by the company itself. I shall therefore take 4.1 per cent. as the proper figure for gas unaccounted for."

Special Master Graham, in the prior suit of the plaintiff company, recognized the same principles that are recognized by Judge Hand. He said:

"The company has, however, by resolution of its Board of Directors, arbitrarily fixed the amount in the case of the subsidiaries at 8 per cent.

"The plaintiff company itself has also reported its own unaccounted for gas in

| | | | |
|---|---|---|---|
| 1910 ..... | 6.83 | 1915 ..... | 6.38 |
| 1911 ..... | 7.66 | 1916 ..... | 7.08 |
| 1912 ..... | 6.80 | 1917 ..... | 7.75 |
| 1913 ..... | 5.60 | 1918 ..... | 8.81 |
| 1914 ..... | 5.99 | 1919 ..... | 8.71 |

"The fact of the relatively high loss rate both of the system and of the plaintiff, may be at least partially accounted for by the pressure it was using in sending the gas over the entire system.

"In my opinion, the percentage of unaccounted for gas thus arbitrarily fixed, is too low, however, for the three so-called Fourth Ward companies, the Woodhaven, Jamaica and Richmond Hill & Queens County Gas Companies. These companies are all in Queens County, serving sparsely settled community; the meters are a long distance from the holders, and as Mr. Little said, very closely resembled the territory of the Kings County Gas Light Company. I think they should be allowed fifteen per cent. for unaccounted for gas, and that the balance of the loss should be distributed among the other subsidiary companies and the plaintiff in proportion to their sales and use of gas. This will result in giving the latter companies a percentage of unaccounted for gas in 1919 of 10.05, and for the first ten months of 1920, of 10.63" (Record, Newton v. Brooklyn Union Gas Co., p. 30a).

This disposition of the matter was distinctly confirmed by Judge Mayer.

It appears quite plainly from the figures above given and the figures for 1922 and 1923 which ap-

pear in this case, that unaccounted for of the plaintiff company has been gradually getting worse and worse which is another way for saying that the efficiency of its distribution system has been falling.

Special Master Graham noted in his opinion in 1923 that at that time the unaccounted for of several companies had been increasing for the few years past. Since 1920, however, the reverse is the case. While the Consolidated Gas Company, in its prior suit, claimed 7% unaccounted for, in its present litigation just concluded it claimed only 4.31%. The Kings County Lighting Company, which Special Master Graham compared with the three Fourth War companies, subsidiaries of the appellee, had an unaccounted for in 1920 of about 13.58%. The Kings County Lighting Company has reduced its unaccounted for to 8.99%.

In view of all the circumstances it is earnestly contended that the appellee did not sustain the burden of proving that the unaccounted for in this case is reasonable. The appellant contended below and still contends that the appellee should be held to unaccounted for comparable with that of the Consolidated Gas Company which company is very close to the plaintiff company geographically, and is the only company comparable to it in density of consumption and amount of annual sales. 5% in the face of all of the proof or lack of proof in the record is certainly a fair allowance for lost gas.

As to this the Court below said:

> "The Attorney-General contends that unaccounted for gas, that is due to leakage, condensation, expansion and contraction, among other things, should be allowed at an arbitrary figure of 5%, but I do not agree with him because in my opinion the proper method is to allow it on the basis of the companies own

records which show the results of experience" (p. 218).

The difficulty with this argument is that there are no "records which show the results of experience" as to the unaccounted for gas of appellee. We know what unaccounted for is for appellee and its subsidiaries combined. There is no doubt that the main reason for the large percentage of unaccounted for gas by the Brooklyn Union Gas Co. is that it pumps gas into the high pressure mains serving the subsidiary territory. Futhermore the subsidiary companies serve a much less sparsely settled territory and the percentage of unaccounted for gas should be much higher in their territory than in the territory of appellee. The Master recognizes this point in his statement (p. 72) but fails to make any finding, apparently because no proof was offered by the company as to what such figure should be. How much should be allocated to the appellee, however, is necessarily a matter of estimate and not of records. The considerations above urged indicate conclusively that 5% would not be unreasonably low for this company. Indeed since the close of the testimony in this case the unaccounted for has actually been reduced to 7% for the system which amply justifies 5% for the appellee.

Applying this percentage of 5% to the cost of making gas gives us a cost per M sold of 46.35 cents. This compares with the figure of 49.03 cents per M found by the Master for gas sold, and practically the book figure of the Consolidated Gas Company of 48.45 cents in its recent litigation. The difference is entirely accounted for by the difference in price of oil paid by the two companies.

## Cost of Distribution.

In a small company which is independent the cost of distribution of gas is readily ascertainable. The uniform system of accounts classifies the expenditures in such a way that the books must generally be kept with accuracy and must show the cost of distribution. Such a company is the Kings County Lighting Company whose case has recently been before the Special Master appointed by this Court. The Special Master Almeth Hoff found in his report recently filed that the distribution expenses of that company amounted to 24.25 cents per M cubic feet sold for the year 1923. This is the sum of various distribution expenses less the operating revenue (see Kings County Record, p 66). This Kings County Lighting Company is a small company doing business in a sparsely settled portion of the Borough of Brooklyn, 29th Ward, a district found by the Special Master, Mr. Graham, in the former litigation of the plaintiff company, as noted above, to be comparable with that of the three small Fourth Ward companies, subsidiaries of the plaintiff.

It is self evident that the distribution expenses of a small company of this kind should be less than those of a large company, yet the Master in this case has found that the distribution expenses for the year 1923 of the plaintiff company were 25.12 cents per M (Finding 185, p. 151; from the sum of all items in the expense account except production expenses, general amortization and taxes, deduct miscellaneous operating revenues). On a comparative basis alone it is earnestly contended that the Brooklyn Union Gas Company ought to be held to distribution expenses of not to exceed 23 cents.

The difficulty in ascertaining the actual distribution figures of the plaintiff company lies in the fact that it superintends the distribution of the gas

not only to its consumers but to the consumers of its subsidiary companies and does a vast amount of work for these subsidiary companies in ordering supplies, furnishing gas, repairing mains, furnishing gas appliances and various other matters. The fact that it does these services for its subsidiaries makes it possible for it to make its distribution expenses appear greater or less as it charges its subsidiary companies less or more for various services which it and its officers render to the subsidiaries.

All of the gas for all of the companies as has been shown, is made by the plaintiff company. The officers of the plaintiff company are also the officers of the subsidiary companies; all of the accounting for the subsidiary companies is done by the plaintiff's employee (Finding 121, p. 125); all construction work for the subsidiaries is contracted for and superintended by the plaintiff company (p. 388). In the case of all the mains and services installed by the subsidiaries the work is actually done by the plaintiff company (pp. 483, 484). All gas appliances are purchased by the plaintiff company and sold at cost to the subsidiary companies, although the plaintiff bears all the expense of promotion of such appliances, of demonstrating them, of storing them and of delivering them to the consumers of the subsidiaries (Finding 130, p. 127).

An attempt was made by plaintiff's witness Blanchfield and its auditor Payne, to allocate the joint expenses between the plaintiff company and its subsidiaries. In certain particulars this allocation seemed to be fair, but there are several instances which show that the tendency was to load the plaintiff company so that its distribution expenses would be higher than if it were an independent company, for example:

The subsidiary companies were not charged with

the cost of any of the gas which was used for manufacturing gas at the works, or for power or light at the holder station (p. 811).

Nor were the subsidiary companies charged anything for gas used at the general office building where the work of all the companies was carried on (p. 812).

Nor were the subsidiary companies charged anything for repairs to the distribution system or transmission mains, although of course these repairs accrued to the benefit of the subsidiaries (pp. 813, 871, 888).

Nor was any charge made to the subsidiary companies for any of the overheads in repairing the meters of the subsidiary companies—such overheads including the reasonable rental of the buildings, the superintendence, etc. (p. 814).

Nor were the subsidiary companies charged anything for bringing their meters to the repair shops, these expenses being borne entirely by the plaintiff company (p. 814).

Nor was there any charge to the subsidiary companies for testing and inspecting the new meters when they first came into the plaintiff company for distribution to the subsidiary companies (p. 827).

Nor was there any account taken in the allocation of general officers' salaries of the fact that a large part of the business of the Flatbush Gas Company was an electric business superintended by the officers of the plaintiff. The allocation was entirely on the basis of the gas sales alone (p. 831).

Nor was there a charge to the subsidiaries of any part of the expense of the new business department (p. 841).

Nor was there any charge to the subsidiaries of any part of the expense of demonstration or advertising nor of any part of the expense of operating and maintaining the building at 1024 Fulton Street

where all of the appliances for all of the companies were stored (p. 841).

Nor was any charge made to the subsidiaries for any of the expense of storage, insurance, gasoline, oil and repairs of automobiles which belong to the companies (p. 841).

Nor was there any charge made to subsidiaries for the expense of hauling pipe in the subsidiary territory except the wages of the chauffeur who drove the vehicle (p. 842).

Nor was there any charge for delivery of appliances to the subsidiary companies' consumers (p. 841).

Furthermore, there were several more fundamental errors in the basis of the allocation, things which indicate quite plainly the tendency to load the plaintiff company. For instance, the allocations were made on the basis of an estimate of the sales for the current year. This estimated increase of sales by the subsidiary companies for the year 1923 proved to be very much smaller than the actual increase. The percentage of sales by the subsidiary companies, instead of being 20.82 of the gross sales of the System, as estimated, proved to be 22.42% of the sales of the System (pp. 873, 874). No correction was made, however, when the estimate proved to be wrong, and as a consequence the subsidiary companies only bore 20% of what was assumed to be a fair return on the manufacturing plants instead of 22½%. The same error ran through all of the allocations of the various distribution expenses. As to this the Court below said:

> "The difference between the amount of gas that had been served during the year, as found by a calculation at the close of the year, and the amount estimated at the beginning of the

> year as the amount that would be required, was too small to justify recasting the system of accounting, and I see no reason for requiring it" (p. 216).

Of course the proper subject of the Court's inquiring was the single question, "What did it cost the appellee as distinguished from its subsidiaries to make and distribute gas?" It was conceded and contended by appellee that the proper method of allocating certain expenditures was on the basis of gas sales for the respective companies. This being so the Court should have made the calculation on the basis of actual rather than estimated sales. There would, moreover, be no question of "recasting the system of accounting." The courts are not bound by the books nor is it necessary for them to be "recast" before findings can be made. Furthermore, the defendants put in evidence tables which reallocated these expenses on the basis of sales (Defts. Exs. 151, 152, 153, 154, 155, 156, 157, 158, 167, 171, pp. 2187-2199). The Court should have found in accordance with the actual facts as contained in the Defendants Exhibits referred to above and it committed error in failing to make the necessary deduction.

Again, the figure for return on the investment in the manufacturing plants and other buildings jointly used was the book figure, as shown on the books of the plaintiff company. This figure, Mr. Blanchfield took, he said, "because I thought it was the reasonable thing to do" (p. 890). In this he agreed with the defendants in this case, but the Master and the Court below have allowed the appellee a return not on the book figure of these properties, but on an inflated figure that more nearly approximates the so-called reproduction cost, plus overheads. Obviously, if the plaintiff company is

to have a return upon reproduction cost its subsidiaries should likewise pay a return on the portion of the property used for them on the reproduction cost of that property.

Again, the plaintiff company some years ago built a 10,000,000 cubic foot holder for the Newtown Gas Company. The Newtown Gas Company had very little use for such a larger holder, but it was in the territory covered by the Newtown franchise, and accordingly it was built in the name of the Newtown Gas Company. All of the money to build this holder was furnished by the Brooklyn Union Gas Company. The Brooklyn Union Gas Company charges the Newtown Gas Company 6% interest on the amount which it cost to build this holder. It has contracted, however, with the Newtown Gas Company to pay that company a return of 8% on this same cost plus all of the expenses of operation of the holder. This plainly is a simple gift of 2% interest per year by the plaintiff company to the Newtown Gas Company. As to this the Court below says after stating the facts:

> "This transaction does not present to my mind anything requiring correction, especially when you consider the statement from the defendant Attorney-General, that the Newtown Gas Company had no need of such holder from which I understand that it was built for the use of the plaintiff, the tenant, but it simply represents the established difference between interest rates and rental value economically figured" (p. 219).

The statement of the Attorney-General was not that the Newtown had "no use" for the holder but that it had "very little use" for it. As a matter of fact the holder was of course built for the system as a whole, subsidiaries as well as parent com-

pany. It is one of the properties whose operating costs are divided in accordance with gas sales. There should certainly be no artificial increase of cost for such a property. Yet the difference of 2% is purely artificial. There was nothing to prevent the Brooklyn Union from charging the Newtown Company 8% for the money nor was there anything to prevent fixing the rental rate at 6%. The officers and directors are the same persons and could do as they saw fit. That they saw fit to load the parent company for the benefit of a subsidiary is eloquent testimony of their real purpose in all of this allocation.

A great many of the inequities in the allocation above noted are indefinite in amount and the difference which would be made by a proper allocation is exceedingly difficult to calculate. They are cited mainly to show the tendency to load the most advantageously situated company in the system.

Some of the items, however, are susceptible of calculation and as to these we will say a word.

AUTOMOBILE EXPENSES:

As has been pointed out above the allocation made by Blanchfield did not allocate to the subsidiaries any of the automobile expenses carried under the headings of "Stable Expenses" and "Automobile Expenses." Not only were there no allocations to the subsidiary companies but the records show that the entire automobile expense was charged to operating account; whereas, a large portion of it should have been chargeable to construction, capital and other accounts. The Master so found (Finding 125, p. 126).

The Master in his Findings Nos. 127, 128 (p. 126 finds that of the automobile expenses, 70.824% "were incurred for operating expenses of the plain

tiff company," the balance for "other than operating expenses" and that 7.978% "could be applied to the subsidiary companies. He also finds that "a reasonable allocation of automobile expenses shows that $62,563.58 of the automobile costs for the year 1923 could be charged to fixed capital and non-operating accounts, and $17,104.41 *"could* be deemed applicable to the subsidiary companies," and he further states—"but the same is deemed to be covered into the allocation of various expenses made early in each year, based upon estimated sales of gas by the subsidiaries and the plaintiff and estimated expenses for the year covering the various items of operation costs" (Finding 129, p. 126).

There is no justification in the record for this final statement of the Master as may be readily seen by referring to the testimony of Witness Blanchfield (pp. 885, 886), and witness Payne (pp. 841, 843). This portion of the automobile expense which should have been charged to other than operating expenses was not covered in the allocations as stated by the Master and should be deducted from the operating expenses of the plaintiff, the amount being $79,667.99 (Defts. Ex. 158, p. 2198).

PROMOTION EXPENSES:

As is indicated above the method of the plaintiff company is to charge itself with all the expenses of running the promotion departments, including the sales of appliances, and to give the subsidiary companies the appliances at cost to be sold at a profit to their consumers. The results of this method is graphically shown in Defendant's Exhibit 171 (p. 2199) and are found by the Master in Findings 131 and 132 (p. 127). The gross revenue of the Brooklyn Union Gas Company, from its ap-

pliance department, was $272,568.21 and the expense of this department $269,683.31, leaving a profit to this large company of only $12,885.08. As the Master finds (Findings 134, 135, p. 127) "the fair rental of the building occupied by the New Business Department is not considered as a promotion expense" * * * and when so considered, the sale of gas appliances is conducted at a loss. The smaller subsidiary companies on the other hand had a gross revenue of $132,287.26 but their expenses were only $26,498.36, so that the profits from this department were over $100,000. In other words, the subsidiary companies on half of the business done by the appellee made about ten times the profit of appellee showed. As a matter of fact, as appears, above appellee actually made no profit if rental of the building were included as it should be.

This result was obtained on selling the same articles for the same retail price. The Master has found in his Finding No. 137 (p. 127), that the "equitable amount of expense chargeable to the subsidiary companies would be $89,401.62." Their actual expenses being $26,498.36, the difference to be deducted from the operating statement of the plaintiff company is $62,903.26.

In Finding No. 137 (p. 127), the Master makes the same statement in regard to these expenses that he made above in regard to the automobile expenses—namely, that these items are "deemed to be covered into the allocation of the various expenses made early in each year." As in the case of the automobile expenses this is not the case (see Blanchfield, pp. 867, 902, Payne, p. 841). They were not so deemed by any one but the Master.

THE RESULT OF THE ALLOCATION ON ACTUAL SALES INSTEAD OF ON ESTIMATES:

As above stated, the allocation of distribution expenses was made, not at the close of the year on the basis of the actual sales but on an estimate made early in the year as to what such sales would be. If the actual sales were taken as a basis, the difference in the allocation would amount to $44,503.93 (Finding No. 123, p. 125). This should certainly be deducted from the operating expenses.

GAS USED IN MAKING GAS FOR SUBSIDIARIES:

The Master has found this amount in Finding No. 124 (p. 126), and while it is small it should be deducted. The Master says that "theoretically" it should be charged to the subsidiaries. It should be actually. The sum is $3,236.32.

DEDUCTION FOR ARBITRARY EXCESS OF RETURN FOR NEWTOWN HOLDER:

As pointed out above the plaintiff company loaned the cost of building the Newtown holder to the Newtown Gas Company. For this money it charges the Newtown Company 6%. It contracts, however, and actually does pay to the Newtown Gas Company all the costs of maintaining the holder and a return on the loaned amount of money at the rate of 8%. This difference which is practically a gift to the Newtown Gas Company, amounts to $23,200 per annum.

DISTRIBUTION REPAIRS:

In Finding No. 165 (p. 134) the Master finds that the cost of distribution repairs during the six years from 1918 to 1923, ranged as follows:

| | |
|---|---|
| 1918 ..... | $383,642.47 |
| 1919 ..... | 352,799.67 |
| 1920 ..... | 440,733.13 |
| 1921 ..... | 523,829.00 |
| 1922 ..... | 504,622.94 |
| 1923 ..... | 548,134.67 |

The above comparison makes an interesting study, in view of the well known fact that materials and labor were generally higher in the year 1919 and up to the summer of 1920, when an abnormal decline in price levels occurred. The comparison shows very clearly the abnormal amount of distribution repairs made by the complainant during the years 1921, 1922 and 1923. The operating expenses of the last two years were before the Court. Because of these abnormal expenditures, it is claimed the State law is confiscatory. The repairs were probably necessary. Undoubtedly it was necessary or advisable to make these repairs for many years previously, but the company evidently delayed such work and allowed the repairs to accumulate.

An average expenditure over a period of years should in all fairness be taken, for many of the repairs do not recur each year, but, on the contrary, when once made, endure for some years. It is only by taking an average over a reasonable period that extraordinary expenditures do not serve to defeat the State statute. The saving by taking an average of such repairs for six years is $89,174.36.

TAXES:

The Master's allowance approved by the Court below for taxes for the year 1923 was the sum of $1,322,113.56, which amounts to 8.63 cents per M cubic feet sold (Finding No. 181, p. 148). The Federal Income Tax accounts for $385,141.49, or 2.52 cents per M.

The Master's figure is excessive. The tax actually paid for the year 1923 was based not on the $1 rate prescribed by statute, but on the rate of $1.15 per M. Moreover, this income tax contains a tax on the bond interest obtained by the Brooklyn Union Gas Company from its subsidiary companies. This is clearly not an operating revenue. A calculation of the income tax on the basis of operating expenses above set forth, taking as a basis the $1.00 rate and making deduction for the bond interest received would bring the proper income tax down to a figure of $233,291 a saving over the actual payment of $151,850 allowed by the Master.

## Gross Earnings Taxes.

In computing this gross earnings tax the Master has fallen into an error, undoubtedly unintentionally.

The Master (p. 72) states that he has calculated the difference in the tax due to the difference between the $1.15 rate and the statutory rate and has eliminated this as well as the excess dividends tax. He has taken no account, however, of the income from investments nor, is it believed, has he made the proper calculations for the two items he has considered.

An accurate recalculation of the gross earnings taxes on the basis of $1 rate, leaving out of account the bond interest, gives a figure of $81,481.33 (Ex. 157, p. 2197), a saving of $24,144 on the Master's figure.

## Summary of the Claims of the Defendant Attorney-General.

The claims of the defendant Attorney-General as to the proper findings for operating expenses are summarized in the following statement:

| | | | |
|---|---|---|---|
| Cost per M. made | | | 44.03 |
| Cost per M. sold (unaccounted for 5%) | | | 46.35 |
| Distribution as found by Master | | 27.36 | |
| Less miscellaneous revenue | | 2.24 | |
| Net | | 25.12 | |
| Deduct: | | | |
| Promotion expenses not chargeable to plaintiff (Finding No. 137) | $62,903.26 | | |
| Automobile expenses not chargeable to plaintiff's operations (Finding No. 123) | 79,667.99 | | |
| Gas used chargeable to subsidiaries (Finding No. 124) | 3,236.32 | | |
| Allocation of other expenses to subsidiaries on basis of actual sales and expenses in 1923 | 44,503.93 | | |
| Rent for lease of gas holder should be reduced to 6% | 23,200.00 | | |
| Averaging distribution repairs 1918 to 1923 gives | 89,174.36 | | |
| Total | $302,685.86 | | |
| Cents per M. | | 1.98 | |
| Balance distribution, net | | 23.14 | |
| General amortization | | 1.50 | |
| Uncollected bills | | .36 | |
| Taxes | 8.63 | | |
| Less reductions in gross earnings | $24,173.00 | | |
| Reductions in Federal Income Tax | 151,850.00 | | |
| | $176,023.00 | | |
| Cents per M. | 1.15 | | |
| Balance taxes | | 7.48 | |
| Net distribution cost | | | 32.48 |
| Net operating cost | | | 78.83 |
| Available for return $3,239,089 | | (per M.) | 21.17 |

This figure of $3,239,089 is equivalent to a 6% return on $53,984,816.

This figure is arrived at, as we have pointed out above, by taking production expenses at exactly the same figure found for the comparable Consolidated Gas Company case by Judge Winslow in the District Court, by taking unaccounted for at 5% which is 15% higher than unaccounted for in the Consolidated case, by taking the distribution expenses plus uncollectibles at 23.14 cents, which is just one cent below distribution expenses found by the Special Master for the small Kings County Lighting Company and by adjusting the actual taxes of the plaintiff company only in amounts which plainly are proper. The figure of return here given of $3,372,202 is equivalent to 9.63% on the value for which the defendant Attorney-General contends of $35,000,000. If this return were actually received by the plaintiff company, it would enable it to pay the interest on that portion of its bonds applicable to its own operation and dividends of 16.5% on that portion of its capital stock applicable to its own operations.

On the other hand, if the Master's excessive figures are approved by the Court, the Court will approve the payment of all the bond interest on bonds applicable to plaintiff's business and property and the dividend of 23% on the capital stock applicable to plaintiff's business.

Both these calculations are on the assumption, of course, that Federal Income Taxes will be paid before dividends.

## POINT VI.

**The statute in question should not be declared unconstitutional unless the Court finds that the rate of return would have been less than six per cent.**

The Master has found that the plaintiff should be permitted to earn at least 8% on the present value of its property and has made a formal finding to that effect (Finding 193, p. 154).

The Court below after reciting that appellee's witnesses testified that 8% was necessary and stating that defendant-appellant contended that 6% was sufficient says:

> "Whatever force there might be to the argument of the defendants under some circumstances, it seems lost in the instant case when you consider that bonds issued by this plaintiff while under the regulation of the Public Service Commission ,and with its approval, bear interest at the rate of 7% per annum, showing clearly that the lending public did not consider 6% as an adequate return" (pp. 219, 220).

Neither, by the same token, did the lending public demand 8% on its money. And today Brooklyn Union 5½% bonds are quoted at 156 and its 4% stock at 94.

*The situation of appellee is not materially different from that of the Consolidated Gas Company and what has been said in appellant's brief in that case* (pp. 109-117) *is equally pertinent here both as to the Law and Facts. The Court is respectfully referred thereto.*

## POINT VII.

**The price and standard provisions of Chapter 899 of the Laws of 1923 are so independent of each other that this Court should declare them separable, and in the event the standard provision is found unconstitutional the price provision may still stand.**

To the argument on the law contained in our brief in Ottinger v. Consolidated Gas Company (pp. 139-151), we respectfully refer the Court.

The Court below briefly disposes of defendant-appellant's arguments in respect to severability of the rate and standard provisions (pp. 224) and concludes that:

> "The provisions of the statute as to rate and standard are not severable."

The Master, however, shed a novel light on the subject saying:

> "The provision as to rate having been found confiscatory, that as to standard would be deemed to survive while the orders of the Public Service Commission requiring compliance with the standard as well as its further orders, fixing new rates, would be subject to judicial review as provided in the original statute. I should be disposed to adopt such a construction were it not that the learned counsel for plaintiff has pointed out that even so, upon the authority of *Bronx Gas and Electric Company* v. *P. S. Comm.*, 108 Misc., 180 s. c., 190, A. D., 13, the further provision of the statute would survive, namely, 'The Public Service Commission, notwithstanding any other provision of this chapter, shall not allow a rate or charge in the case of such cities in excess of

such sum.' As a result, we should have a statute requiring the delivery of 650 B. T. U. gas and divesting the Public Service Commission of power to allow a constitutionl rate, inferentially reserving that power to the legislature itself. *Morrell* v. *Brooklyn Borough Gas Company*, 195, A. D., 1 s. c., 231 N. Y., 398. This would leave the plaintiff without restraint as to price to be charged its consumers. Surely such a construction would be at variance with the clear purpose of the act. It must therefore be rejected."

It may be said with deference that the Master is here straining at a gnat while swallowing a camel. The plaintiff would be no more "without restraint" as to rates if the 650 standard were allowed to survive than it is now under the present standard. Indeed if, as the courts have held, the rate and standard are inseparable and the Commission's power to fix standards has been repealed the gas companies are not only not without restraint as to rates but they may also furnish gas of any standard that pleases them.

**The facts appearing in this record and of recorded cases indicate that there would be little if any danger connected with changing to the statutory standard even without adjustment of appliances and that if time were given to adjust appliances there would be neither danger nor inconvenience.**

As before noted plaintiff's engineer testified that if 3 gallons of gas oil were used per thousand cubic feet the resulting gas would contain 540 British Thermal Units per foot and have a light value of 16.5 to 18.5 candle power. If 4 gallons of gas oil per thousand were used the B. T. U. content would

be 625 and the candle power 22 (p. 397). This is candle power at the works.

It further appears from the evidence that during late 1920 and early 1921 the plaintiff because of an alleged difficulty in getting gas oil was delivering a gas of far less than the statutory candle power standard. The record of average candle power at the works, with the corresponding approximate B. T. U. content was as follows (p. 737).

| | | |
|---|---|---|
| 1920 | | |
| January ..... | 22.79 | 625 |
| February ..... | 19.73 | 600 |
| March ..... | 19.38 | 600 |
| April ..... | 17.91 | 535 |
| May ..... | 17.21 | 537 |
| June ..... | 18.22 | 537 |
| July ..... | 17.11 | 537 |
| August ..... | 16.36 | 537 or less |
| September ..... | 15.94 | 537 or less |
| October ..... | 15.54 | 537 or less |
| November ..... | 15.45 | 537 or less |
| December ..... | 15.35 | 537 or less |
| 1921 | | |
| January ..... | 15.73 | 537 or less |
| February ..... | 20.05 | 600 |
| March ..... | 23.26 | 650 |
| April ..... | 24.55 | 650 |
| May ..... | 24.56 | 650 |

The yearly average of the City tests taken approximately one mile from the different works were as follows (p. 739):

| | 1920 | 1921 |
|---|---|---|
| Citizens ..... | 13.02 | 18.99 |
| Fulton ..... | 10.79 | 18.56 |
| Nassau ..... | 13.81 | 18.45 |
| Williamsburg ... | 12.76 | 18.99 |
| Metropolitan ... | 12.59 | 19.37 |
| All ..... | 12.57 | 19.04 |

The Consolidated during 1918 also fell down badly on candle power due to toluol extraction. Judge Hand says of the Consolidated situation at this time:

> "The defendants prove many violations under their own tests. In 1916 and 1919 the average of all monthly tests was never below 22 (candle power) for any month; in 1917 the month of November averaged (taking all ten) 21.80 and in December 21.99. The year 1918, was, indeed, quite different. From May 1st to November 1st the United States had commandeered the oil in two of the plants for making toluol, *and the standard collapsed,* falling in October to 14.92 (average of all 10 observations). For the other months of 1918 the averages are as follows: January 20.61; February, 20.52; March, 21.63; April, 21.51; December, 20.98."
>
> Consolidated Gas Co. v. Newton (supra), p. 244.

Certainly both in the case of the Brooklyn Union and in the case of the Consolidated the gas went down from 650 B. T. U.'s and more much lower than 537 B. T. U.'s and upon again to 650 and more. The actual variation between individual tests of course was greater than the average figures indicate.

So we see that by their own records, appellee as well as the Consolidated went from 650 gas to 537 gas and back again *without any loss of life, without any explosions, without any large expense for special inspections, indeed without any of the dire results that witnesses for the appellee were sure would occur.*

**The 22 candle power standard apparently was more dangerous, more unstable and more impossible of performance than 650 B. T. U. standard. Yet its constitutionality was not attacked and it seemed to give the people general satisfaction for nearly twenty years.**

It will be recalled that the chief arguments against the high B. T. U. standard are that it will be extremely variable and so will cause consumers appliances to become out of adjustment and result in poor service and probable danger to life and health.

Apparently, however, the candle power standard was even more subject to such variations as to thermal content.

In the record in this Court in the case of Newton v. Consolidated, page 17020, there appears a tabulation of tests made for heating value of the 22 candle power gas sent out by plaintiff-appellee during the first half of 1917. In 702 tests the gas ranged from 27 candle power to 16.9 candle power and from 730 B. T. U. to 568 B. T. U. Yet the unanimous testimony in the cases now before this Court is that a variation of more than 50 B. T. U.'s would be dangerous. The same tabulation shows that gas of as high a thermal content as 750 B. T. U. was furnished and the average for all companies was 656 B. T. U. gas. In the face of this it is hard to be convinced of the real impossibility of furnishing 650 B. T. U. gas.

The conclusion drawn from this table, moreover, that candle power gas of whatever standard is more variable in thermal content than B.T.U. gas is expressly borne out by the report of the Public Service Commission on standard, above referred to. In that report the Commission says (R., pp. 1627, 1630):

"An appliance adjusted to 650 B. T. U. gas, Mr. Merrifield said, will function with 600 B. T. U."

(It will be noted that there is no slightest suggestion that 650 B. T. U. gas is impossible of production.)

The Commission continues:

"The fact, therefore, that there must be an adjustment has direct relation to gas quality, and if the adjustment is to function serviceably it must be directed to a gas the quality of which will not vary beyond the points to which the adjustment is applicable.

"Mr. Klump testified in case No. 108-A (p. 46) that the principal advantage of B. T. U. gas over candle power gas is uniformity; that it can be burned with a fixed ratio of air; and that no further adjustment is necessary after once properly adjusted.

"Hence it is that from the standpoint of adjustment, the question is as to the extent of possible variation in the quality of gas produced, and Mr. Phillips testified that '*the variations under a candle power standard * * * will be much greater than under a B. T. U. standard*' and '*the mere adoption of heating value, therefore, in substitution for the candle power is a step in the right direction, regardless of the lowering of the heating value standard.*'"

And again, it was the opinion of another witness, Charles D. Jenkins, Chief of the Gas Inspection Division, Department of Public Utilities, State of Massachusetts:

"Under the use of the standard of candle power there has been a wide fluctuation, ac-

cording to the weather and other circumstances in the calorific value of the gas, and he further believed that there *will be less fluctuation in gas measured for its B. T. U. value than in the same gas measured at the same time for its candle power*" (p. 1634).

The change the Legislature made therefore was apparently by common consent a change for the better as compared with the 22 candle power standard. Yet that standard, as has been said, was in existence for many years without complaint on the part of any consumer so far as any record shows and it was never attacked as impossible of performance in any of the upward of twenty litigations and Commission investigations in which this question might have been raised. Never was there a suggestion that high standard gas was impossible of production, dangerous to health or otherwise unconstitutional.

Moreover the report of the Public Service Commission above referred to seems specifically to refute the theory that no change of standard involving a change of more than 50 B. T. Us. could be made safely without adjusting of appliances.

For instance the report states (p. 1653) that in Providence a change from 580 B. T. U. to 510 B. T. U. gas was made in "practically a week's time." And Mr. Merrifield's testimony is quoted to the effect that "for a period of some two years the New York and Richmond Gas Company has been furnishing gas of varying B. T. U. content, averaging about 550 or 540, *without authorization, and instead of 22 candle power gas.*"

"Mr. Merrifield judged from the effect upon his appliances that *the change from* 22

*candle power gas to that of a B. T. U. content was effected suddenly* and he said:

'The adjustment which had previously met the conditions of the gas supply was not proper for the newer gas, *so I had to readjust my appliances*' " (p. 1658).

What happened to the other thousands of consumers of the New York & Richmond Gas Company who were not gas engineers and probably knew no more than the rest of us about adjusting gas appliances does not appear. There is no record of sudden deaths in great numbers, however.

The real fact appears conclusively from this case and that of the Brooklyn Borough (p. 1657) is that the change made without adjustment caused complaint and that when adjustments were made complaints ceased. There was no danger—only inconvenience and it is fair to assume that a change upward, in view of the Consolidated and Brooklyn Union experience during the war would not even cause complaints of "poor gas."

## Standard and rate are considered severable by the Courts, the Commission and the Companies.

What has just been shown indicates conclusively that rate and standard have always been considered severable by the companies. Beginning with 1918 the Consolidated and the Brooklyn Union Companies while maintaining the rate did not consistently maintain the candle power standard, and this course received the approval of the District Court.

See

Consolidated Gas Co. v. Newton (supra);
Brooklyn Union Gas Co. v. Nixon (supra).

The Kings County Lighting Company as Judge Hough said in his decision in

> Kings County Lighting Co. v. Nixon, 268 Fed., 147, 148,

> "persisently and deliberately disregarded the candle power requirement."

Judge Hough excused it on account of the greater cost which the company could not bear. He said, however, that the company might well have "based its suit on the allegation that that the 22 candle power requirement was in itself confiscatory, having regard to the admittedly greater expense of complying with the standard of illumination."

> Kings County Lighting Co. v. Nixon, supra, page 148.

Neither the Kings County Lighting Company nor the other companies did attack the standard in the former case as other than "unnecessary and wasteful" as it was found by Judge Hand to be in

> Consolidated Gas Co. of N. Y. v. Newton, supra, page 243.

Nor was it ever suggested after these litigations that the standard did not still prevail though the rate was declared confiscatory.

As appears above the appellee went back to the 22 candle power standard as soon as the war and the litigation was over. The Consolidated did the same as soon as the Government ceased extracting toluol.

> Consolidated Gas Co. v. Newton, supra, page 244.

The Kings County did not go back to the 22 candle power even after it began charging $1.50 per M

for gas but its failure to do so was not by reason of any claim that the 22 candle power standard no longer existed.

It appears in this record (p. 1647) that the Kings County Company applied for and obtained from the Public Service Commission on March 23, 1922, an order "fixing the standard of 525 B. T. U. for gas manufactured and sold by Kings County Lighting Company 'in lieu of a 22 candle power standard.'"

The Public Service Commission also recognized the continued existence of the 22 candle power standard in the case of the Brooklyn Borough Gas Company (Rec., page 1646) when a similar order was entered allowing that company to change from the 22 candle power standard to a 525 B. T. U. standard.

In its general investigation which resulted in its order of August 1, 1922 it specifically stated that the 22 candle power statute was "the law applicable" (Rec., p. 1608).

It appears quite plain then that a standard can survive and has survived the rate fixed with it.

Moreover the Public Service Commission in fixing the rate and standard now prevailing did so in two separate proceedings.

## POINT VIII.

**The statute should not be declared confiscatory until the appellee has experimented with the statutory rate.**

*Upon this point we respectfully refer the Court to our brief in Ottinger* v. *Consolidated* (pp. 119-123).

## POINT IX.

**Every presumption is in favor of the validity of the statute, and the burden of proof is upon the party assailing such statute to establish its unconstitutionality beyond a reasonable doubt.**

*Upon this point we also respectfully refer the Court to our brief in Ottinger* v. *Consolidated* (p 117-119).

## POINT X.

**The decision of the Court below should be reversed and the case remanded with instructions to enter a decree dismissing the complaint.**

Dated, New York, October 11, 1926.

Respectfully submitted,
JOHN HOLLEY CLARK, JR.,
Solicitor for Appellant Ottinger,
120 Broadway,
New York.

WILLIAM HAYWARD,
JOHN HOLLEY CLARK, JR.,
CHARLES E. BUCHNER,
of Counsel.